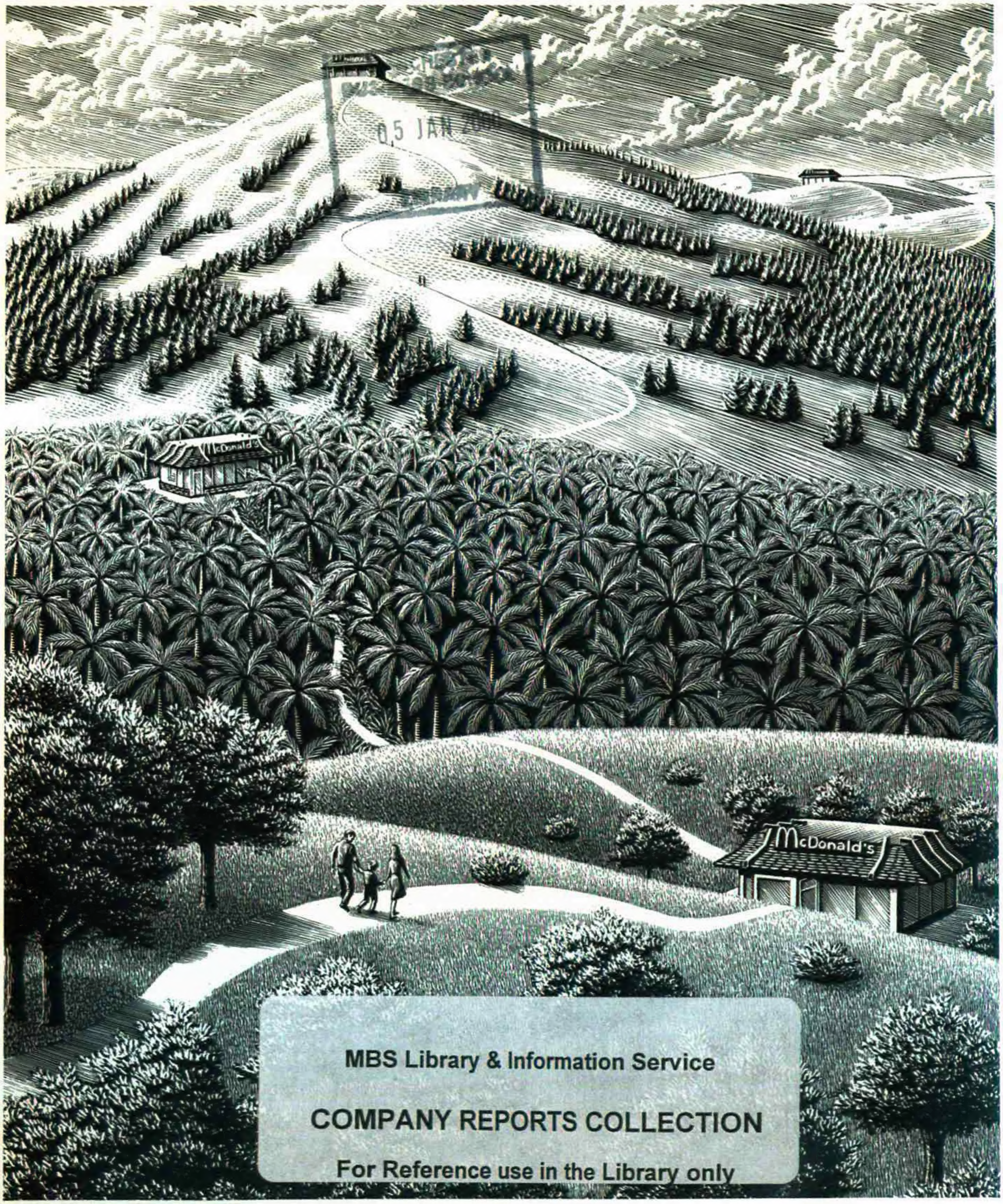
The Annual

McDONALD'S CORPORATION 1998 ANNUAL REPORT



McDonald's vision is to be the world's best quick-service restaurant experience. Being the best means consistently satisfying customers better than anyone else through outstanding quality, service, cleanliness and value. Supporting this vision are five global strategies:

- develop our people at every level of the organization, beginning in our restaurants
- foster innovation in menu, facilities, marketing, operations and technology
- expand our global mindset by sharing best practices and leveraging our best people resources around the world
- continue the successful implementation of changes underway in McDonald's USA
- long term, reinvent the category in which we compete and develop other business and growth opportunities

11-year summary	**1998**	1997	1996	1995	1994	1993	1992	1991	1990	1989	1988
(Dollars in millions, except per share data)											
Systemwide sales	**$35,979**	33,638	31,812	29,914	25,987	23,587	21,885	19,928	18,759	17,333	16,064
Systemwide sales by type											
Operated by franchisees	**$22,330**	20,863	19,969	19,123	17,146	15,756	14,474	12,959	12,017	11,219	10,424
Operated by the Company	**$ 8,895**	8,136	7,571	6,863	5,793	5,157	5,103	4,908	5,019	4,601	4,196
Operated by affiliates	**$ 4,754**	4,639	4,272	3,928	3,048	2,674	2,308	2,061	1,723	1,513	1,444
Total revenues	**$12,421**	11,409	10,687	9,795	8,321	7,408	7,133	6,695	6,640	6,066	5,521
Operating income	**$ 2,762**[1]	2,808	2,633	2,601	2,241	1,984	1,862	1,679	1,596	1,438	1,288
Income before provision for income taxes	**$ 2,307**[1]	2,407	2,251	2,169	1,887	1,676	1,448	1,299	1,246	1,157	1,046
Net income	**$ 1,550**[1]	1,642	1,573	1,427	1,224	1,083	959	860	802	727	646
Cash provided by operations	**$ 2,766**	2,442	2,461	2,296	1,926	1,680	1,426	1,423	1,301	1,246	1,177
Capital expenditures	**$ 1,879**	2,111	2,375	2,064	1,539	1,317	1,087	1,129	1,571	1,555	1,321
Treasury stock purchases	**$ 1,162**	765	605	321	500	628	92	117	157	497	136
Financial position at year end											
Net property and equipment	**$16,042**	14,961	14,352	12,811	11,328	10,081	9,597	9,559	9,047	7,758	6,800
Total assets	**$19,784**	18,242	17,386	15,415	13,592	12,035	11,681	11,349	10,668	9,175	8,159
Total debt	**$ 7,043**	6,463	5,523	4,836	4,351	3,713	3,857	4,615	4,792	4,036	3,269
Total shareholders' equity	**$ 9,465**	8,852	8,718	7,861	6,885	6,274	5,892	4,835	4,182	3,550	3,413
Per common share[2]											
Net income	**$ 1.14**[1]	1.17	1.11	.99	.84	.73	.65	.59	.55	.49	.43
Net income–diluted	**$ 1.10**[1]	1.15	1.08	.97	.82	.71	.63	.57	.54	.48	.42
Dividends declared	**$ .18**	.16	.15	.13	.12	.11	.10	.09	.09	.08	.07
Market price at year end	**$ 38 7/16**	23 7/8	22 11/16	22 9/16	14 5/8	14 1/4	12 3/16	9 1/2	7 1/4	8 5/8	6
Systemwide restaurants at year end	**24,800**	23,132	21,022	18,380	15,950	14,163	13,093	12,418	11,803	11,162	10,513
Systemwide restaurants by type											
Operated by franchisees	**15,281**	14,265	13,428	12,217	10,965	9,933	9,237	8,735	8,131	7,573	7,110
Operated by the Company	**5,512**	5,000	4,357	3,816	3,238	2,746	2,551	2,547	2,643	2,691	2,600
Operated by affiliates	**4,007**	3,867	3,237	2,347	1,747	1,484	1,305	1,136	1,029	898	803
Number of countries at year end	**114**	109	101	89	79	70	65	59	53	51	50
Number of shareholders at year end *(in thousands)*	**888.2**	880.2	904.6	769.7	609.2	464.5	398.3	371.7	362.6	330.5	168.6

(1) Includes $162 million of Made For You costs and $160 million special charge related to the home office productivity initiative for a pre-tax total of $322 million ($219 million after tax or $0.16 per share)

(2) Restated for two-for-one stock split in March 1999

About the cover
Paths by Douglas Smith. From mountaintops to arid deserts, from tropical forests to grassy plains, customers around the world take paths to McDonald's. In 1998, McDonald's proudly served more than 40 million customers each day.

1998 performance

McDonald's strategies are to increase customer satisfaction, profitability and market share. Our efforts produced impressive results in 1998[1]:

- McDonald's stock delivered a total return to investors of 62 percent for the year and 21 percent compounded annually over the past 10 years.
- Return on average assets increased to 16.4 percent from 16.0 percent in 1997; return on average equity increased to 19.5 percent from 19.0 percent in 1997.
- Diluted earnings per share increased 10 percent for the year and grew at a 12 percent compound annual growth rate over the past 10 years. In constant currencies, the 1998 increase was 12 percent.
- McDonald's global sales reached $36 billion, a 10-year compound annual growth rate of 8 percent.
- In constant currencies, operating income increased 13 percent in the U.S., 14 percent in Europe, 8 percent in Asia/Pacific and 18 percent in Latin America.
- Our share of the U.S. hamburger market reached its highest level this decade.

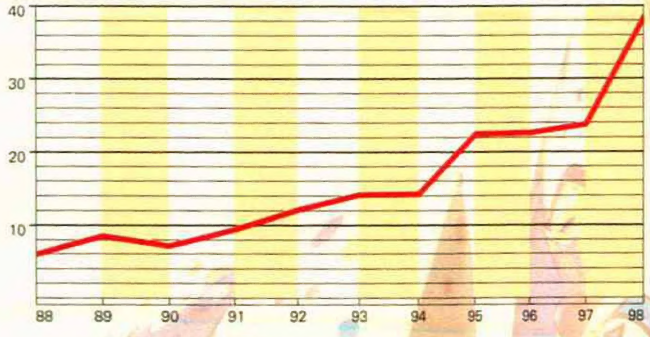
Market capitalization at year end
In billions

- Outside the U.S., we have 48 percent of the globally branded quick-service restaurants and 63 percent of the sales.
- Free cash flow nearly tripled to $887 million.
- The Company purchased nearly $1.2 billion of common stock during the year.
- Average U.S. owner/operator cash flow increased 12 percent for the year.

(1) These1998 highlights exclude Made For You costs and the special charge related to the home office productivity initiative.

Market price per common share at year end

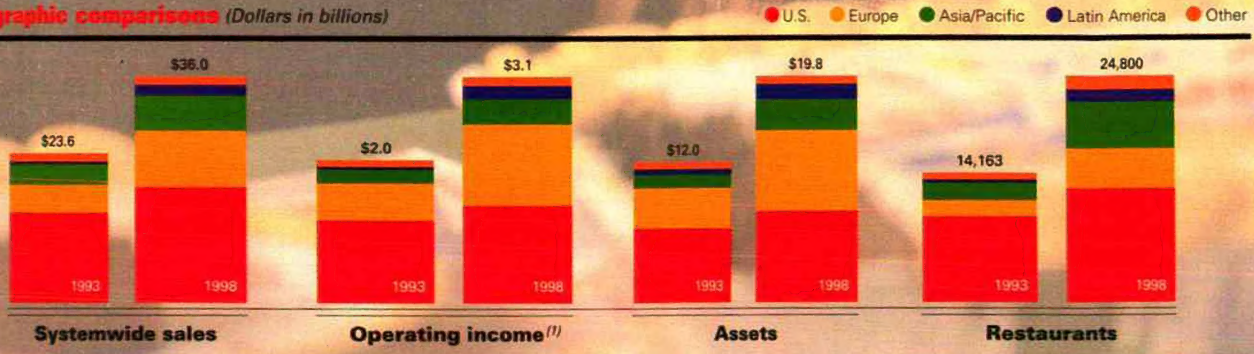
In dollars, restated for stock splits



Systemwide restaurants *(at year-end **1998** and 1993)*

	1998	1993
Systemwide restaurants	**24,800**	14,163
United States	**12,472**	9,397
Europe	**4,421**	1,801
Andorra	**2**	1
Austria	**121**	45
Belarus	**5**	0
Belgium	**62**	21
Bulgaria	**13**	0
Croatia	**12**	0
Czech Republic	**48**	8
Denmark	**87**	29
England	**810**	478
Estonia	**6**	0
Finland	**90**	21
France	**708**	293
Germany	**931**	496
Greece	**38**	4
Hungary	**66**	17
Iceland	**2**	1
Ireland	**47**	18
Isle of Man	**1**	0
Italy	**201**	19
Jersey	**1**	0
Latvia	**6**	0
Liechtenstein	**1**	0
Lithuania	**6**	0
Luxembourg	**4**	3
Macedonia	**2**	0
Malta	**7**	0
Monaco	**1**	1
Moldova	**1**	0
Netherlands	**187**	95
Northern Ireland	**17**	5
Norway	**48**	14
Poland	**130**	10
Portugal	**60**	5
Reunion Island	**3**	0
Romania	**35**	0
Russia	**45**	3
Scotland	**64**	28
Slovakia	**7**	0
Slovenia	**11**	1
Spain	**188**	63
Sweden	**177**	68
Switzerland	**101**	37
Ukraine	**19**	0
Wales	**35**	11
Yugoslavia	**15**	6
Asia/Pacific	**5,055**	1,880
Australia	**666**	388
Brunei	**1**	1
China	**220**	13
Fiji	**2**	0
Guam	**6**	4
Hong Kong	**152**	71
India	**15**	0
Indonesia	**67**	14
Japan	**2,852**	1,042
Macau	**10**	4
Malaysia	**121**	41
New Caledonia	**1**	0
New Zealand	**145**	69
Pakistan	**3**	0
Philippines	**194**	55
Saipan	**2**	1
Singapore	**108**	56
South Korea	**131**	24
Sri Lanka	**1**	0
Tahiti	**1**	0
Taiwan	**292**	77
Thailand	**64**	20
Western Samoa	**1**	0
Latin America	**1,405**	379
Argentina	**166**	33
Aruba	**2**	1
Bahamas	**3**	4
Bermuda (U.S. Navy Base)	**0**	1
Bolivia	**5**	0
Brazil	**672**	154
Chile	**42**	6
Colombia	**19**	0
Costa Rica	**22**	9
Cuba (U.S. Navy Base)	**1**	1
Curacao	**4**	3
Dominican Republic	**9**	0
Ecuador	**5**	0
El Salvador	**1**	3
Guadeloupe	**5**	1
Guatemala	**27**	8
Honduras	**5**	0
Jamaica	**11**	0
Martinique	**5**	1
Mexico	**144**	80
Nicaragua	**3**	0
Panama	**21**	11
Paraguay	**9**	0
Peru	**7**	0
Puerto Rico (USA)	**114**	48
St. Maarten	**1**	0
Suriname	**1**	0
Trinidad	**4**	0
Uruguay	**24**	4
Venezuela	**67**	8
Virgin Islands	**6**	3
Other	**1,447**	706
Bahrain	**5**	0
Canada	**1,085**	683
Cyprus	**5**	0
Egypt	**28**	0
Israel	**65**	1
Jordan	**4**	0
Kuwait	**21**	0
Lebanon	**2**	0
Morocco	**7**	1
Oman	**2**	0
Qatar	**4**	0
Saudi Arabia	**33**	1
South Africa	**58**	0
Turkey	**113**	20
United Arab Emirates	**15**	0

Geographic comparisons *(Dollars in billions)*



(1) Excludes 1998 Made For You costs and special charge

Advertisement from Taiwan. "All new spicy McFried Chicken"

TheAnnual

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Year in review

Financial review

Features

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Current financial releases are available via fax at 1-630-623-0172, audio recording at 1-630-623-6543 and on the web at www.mcdonalds.com.

Individual investor presentations by Barbara Ven Horst, Investor Relations, will be given at the following 1999 National Association of Investors Corporation (NAIC) events: Cincinnati, OH–April 17; Pittsburgh, PA–May 1; Moline, IL–May 22. Also, visit our booth at the NAIC Expo, September 15-18, in Nashville, TN.

Individual investors with investment questions about McDonald's, call 1-630-623-7428.

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McDonald's 1998 annual report on Form 10-K may be obtained without charge by accessing McDonald's filings at www.sec.gov or by writing the Investor Relations Service Center at our Home Office address below.

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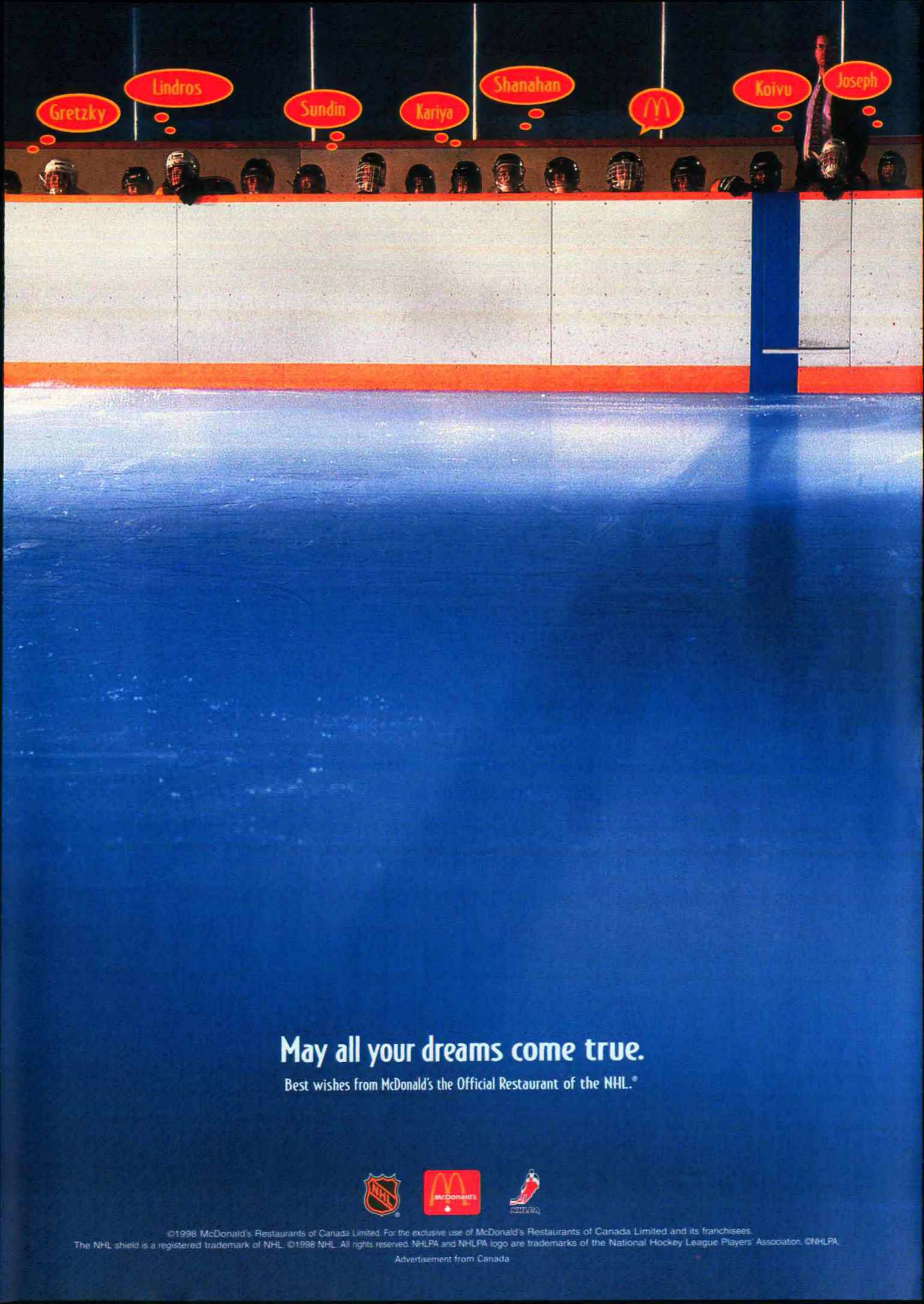

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Dear shareholders:

This is an exciting letter to write for a number of reasons. For one, it is an honor to follow in the footsteps of Ray Kroc, Fred Turner and Mike Quinlan as chief executive officer of McDonald's. I believe leaders cast long shadows, and each of these remarkable men has made an everlasting impact on the McDonald's System. Through their efforts, we have become one of the strongest brands ever. For another reason, it is a pleasure to help chronicle a genuinely remarkable 1998 performance on all fronts for our Company. Finally, I am acutely aware that I am communicating on behalf of literally hundreds of thousands of our committed employees, owner/operators and suppliers. So in equal parts I am proud, grateful and quite humbled to share my thoughts with you on our business performance.

Let me begin by saying thank you to each of our shareholders. We appreciate the investment you have made in McDonald's, and we are committed to repaying your confidence with rich returns. During 1998, our stock delivered a total return of 62 percent, contributing to a five-year compound annual total return rate of 23 percent and a 10-year rate of 21 percent. To those of you with long-term investments in the Company, we value your loyalty. And to those who have recently joined our McFamily of investors, I'm pleased that you've chosen us. I firmly believe the best is yet to come.

During 1998, our stock delivered a total return of 62 percent, contributing to a five-year compound annual total return rate of 23 percent and a 10-year rate of 21 percent.

My unabashed optimism is rooted in a very basic belief: McDonald's is a special company—capable of exceeding even our own high expectations.

Yes, we are perhaps the best-known brand in the world. Yes, we operate nearly 25,000 restaurants in 115 countries. And yes, our size, financial strength and global expertise in development, operations and marketing give us competitive advantages.

But frankly, those are not the reasons why McDonald's is so special. They are instead the results—the by-products, if you will—of something more fundamental and more powerful.

As CEO, it is my responsibility and privilege to travel throughout the world, visiting restaurants and talking with owner/operators, Company people, suppliers and customers. In this capacity, I see firsthand why McDonald's is special, why we have an edge wherever we do business. It is because of our unique heritage—a history of success and innovation—and it is because of the people who embrace that heritage.

You can see the power of our heritage at work throughout the world.

In Miami, it is a restaurant manager who earned a "Manager of the Year" award by day and a law degree by night. In Canada, it is a group of owner/operators who took a risk with a new product, and now their McFlurry desserts are in more than 15,000 restaurants in 36 countries. In Nicaragua, it is the daughter of our original owner/operator in that country who reopened McDonald's after years of civil unrest. In the U.S., it is our entire System responding to a competitive challenge against our World Famous Fries and seeing our potato tonnage increase. In Chicago, it is a 94-year-old crewperson who still delights in satisfying our customers. Around the world, it is 195 Ronald McDonald Houses reaching out with loving support to families in need. It is the magic of Disney, brought to life in a Happy Meal toy for "a bug's life." It's our founder, Ray Kroc, named by *Time* magazine as one of the 20 builders and titans of the 20th century.

And there is so much more. It's two young men in France and Hungary, fresh out of law school, who joined McDonald's as operations trainees and are now CEOs of dynamic, growing McDonald's businesses in their countries. It's a young operations manager who moved from Taiwan to Beijing to open our first restaurant there, and now is president of the Beijing market with 52 restaurants. It's the third-generation owner/operator in Chicago's northwest suburbs who helped pioneer our Made For You food preparation system. It's the minority pork supplier now deriving over one-half of his revenue from McDonald's Japan. It's the Brazilian franchisee, four months with the System, already working on how to add a drive-thru to his shopping mall location. It's our proud association of African-American owner/operators in the U.S. recognized by *Minority Business Report* with its prestigious Advocate of the Year award. And throughout the world, it is the entire McFamily,

pulling together, doing what we can, to help when natural disasters strike the communities we serve.

McDonald's is special because we rely on a powerful heritage —one that enables us to stand tall for the System, especially when we face a challenge.

As an example, let's look at the U.S. business. Just a year ago, there were quite a few naysayers suggesting that the best days of our U.S. business were behind us, that our only opportunities for growth existed overseas. Frankly, those were fighting words—for our U.S. management team, for 2,800 proud owner/operators, and for hundreds of thousands of restaurant managers and crew across the country.

We pulled together as a team, learned from our mistakes, focused sharply on a set of strategies to drive performance at the restaurant level, and proceeded to turn the U.S. business around faster than even we predicted.

Last year, we posted our highest comparable sales increase since 1993. This contributed to our total U.S. System sales increase of six percent in 1998. Also, we surpassed our plans for increasing U.S. operating income. Excluding Made For You costs and a special charge for our home office productivity initiative, we increased U.S. operating income by 13 percent. We plan to build on this momentum under the leadership of Alan Feldman, our new president of McDonald's USA.

Internationally, we faced tough challenges in 1998 due to economic turmoil in a number of countries, and we overcame them as well. I attribute this to the leadership of Jim Cantalupo, who has headed up our international business for the past 11 years.

Jim has always taken a long-term view of growth and development outside the U.S., and this has strengthened our position wherever we do business. We've developed an unsurpassed infrastructure of suppliers, restaurants and management talent, which provides us with the resources and flexibility to deal with difficult cyclical situations. In addition, we protect profits from the economic impact of currency fluctuations by sourcing locally, where practical, and financing expansion with local currency debt.

So while the earnings of other global companies suffered in the face of economic crises in Asia and elsewhere, our international performance was strong. Excluding the effect of foreign currency translation, McDonald's sales outside the U.S. rose 14 percent in 1998, and operating income increased by a solid 12 percent. I'm equally pleased to note that Jim's many contributions were rewarded in 1998 with a well-deserved promotion to vice chairman of McDonald's Corporation and chairman and CEO of McDonald's International.

With our overall results in mind, let me express sincere thanks to each and every customer who visited McDonald's this year. Our continued success is wholly dependent on your satisfaction, and our goal is to make every meal we serve you a "happy meal."

In fact, I firmly believe that the success we had last year, especially in the U.S., was directly related to our intensified efforts to listen better, and respond better, to customer needs.

We've developed an unsurpassed infrastructure of suppliers, restaurants and management talent, which provides us with the resources and flexibility to deal with difficult cyclical situations.

By listening, by focusing on strategic priorities, by motivating people and by encouraging innovation, 1998 was a year in which we extended our considerable lead internationally and achieved a remarkable turnaround in our U.S. business. Many companies would do the equivalent of a corporate "high-five" after such a year. At McDonald's, we are not looking to celebrate. Instead, we are sharpening our strategic focus, resolving to do even better in 1999 and beyond.

These are some of the reasons why I believe McDonald's truly is special.

Sincerely,

Jack M. Greenberg

Jack M. Greenberg
President and Chief Executive Officer, Shareholder

March 15, 1999

What is McDonald's doing to expand its leadership and increase profits in the next century?

by PATRICIA COMMINS, *a freelance business writer. She is a former correspondent for* Reuters America, *covering food and restaurant companies.*

Jack Greenberg is leading McDonald's toward its vision to be the world's best quick-service restaurant experience.

In August 1998, Jack Greenberg became president and chief executive officer of McDonald's Corporation, overseeing the operations of the Company, which span 115 countries. Jack, who previously was McDonald's chief financial officer and later chairman and CEO of McDonald's USA, has earned a reputation as an executive with a passion for excellence. After making his mark on McDonald's U.S. operations, where he implemented many strategic changes, he is leading the Company into the 21st century. Jack sat down recently to talk about his plans and ideas for McDonald's and why he believes the best is yet to come.

As CEO in charge of an expanding global business, what is your vision for McDonald's?

Our vision is to be the *best* quick-service restaurant experience in the world in the eyes of our customers. The only way we can truly measure our success is in terms of customer satisfaction and customer loyalty. Was it fast? Was it friendly? Was it hassle-free? Was it convenient? Did the food taste good? Would you drive by three competitors just to go to McDonald's? This business begins and ends with satisfying customers' needs, and we must satisfy them better than anybody else. This is how we'll grow sales, profits and returns for the McDonald's System. More and more, we've got to become a destination, rather than just a convenient place to stop. To do that, we need to give our customers a differentiating experience.

What are the first steps in making that happen?

Behavior, leadership and focus. I really do believe in leading by example, and that leaders who value teamwork and encourage an open dialogue among team members, get the best thinking from their people and ultimately get better results. Of course, it's also critical to have talented, highly qualified individuals on the team in order to maintain the all-important focus on the real business issues and opportunities.

Who are your key team members?

On the line-management side, there are Jim Cantalupo, Alan Feldman and Jim Skinner. Jim Cantalupo is chairman and CEO of our international business. He is also vice chairman of the Corporation. Alan is president of our U.S. business, and Jim Skinner is president of European operations. Each of these individuals offers the team remarkable operations experience and insight.

On the staff side, Claire Babrowski, executive vice president for restaurant systems, leads our efforts on innovation and best-practice transfer, while Mike Conley, our chief financial officer, keeps the team focused on the financial realities of running a global business. Jeff Kindler, our chief legal officer and head of corporate relations, brings fresh new thinking to our Company, resulting in a sharper strategic focus.

Pat Flynn, Ray Mines and Stan Stein, executive vice presidents for corporate development and business research, franchise relations and human resources, respectively, are also valued team members. Pat challenges us to look at our business and opportunities in new and different ways. Ray brings sensitivity to the highly diverse needs of our owner/operators, along with a reminder of how essential franchising is to McDonald's. Stan leads our effort on the all-important issues involving our employees around the world.

I believe this diverse and highly qualified team provides literally a "world" of wisdom and leadership resulting in smart decision making.

What is management focusing on to give customers a differentiating experience?

Our people and our ability to innovate. Our people are our most important priority. We need to focus on our restaurant staffs in terms of the quality of people we hire, how we train them, how we keep them and how we improve their job satisfaction. We must inspire and motivate them so they can deliver the best possible service to our customers. The same things apply all the way through the corporate ranks. Job satisfaction, professional development and the quality of what we all do each and every day affects our restaurants and our customers.

We also need to continue to innovate to grow our business. That's part of leadership. If you go back to our roots in 1955, we innovated restaurant operations, essentially redefining the preparation and delivery of a meal. Then we enclosed the dining rooms. We added Playlands. We added drive-thrus. Those were facilities innovations. We added breakfast, McNuggets and salads. Those were food innovations. We were the first restaurant ever to advertise on national television. We had the first national advertising cooperative. Ronald McDonald. Happy Meals. Extra Value Meals. Those were part of marketing innovation.

Over the years, all these innovations have had an impact on the growth of our business and on our restaurant sales.

Will innovation include testing more product ideas?

Absolutely. By creating innovative and great-tasting products at a great value, we create a loyal customer following. Not everything you come up with is automatically going to be accepted. But as far as I'm concerned, no product is a "failure." The only failures in this business are not to test an idea in the first place, to be afraid to test it or to take too long to figure out whether something works.

Years ago, I remember bragging that it took seven years to develop Chicken McNuggets. That was our way of showing how seriously we took this business. Today, that would be a terrible mistake. The competitive set, the pace of change, the customers' demands—all mean that we can't spend seven years trying to figure out a product. A "fast-fail" policy is a good one for this business. We learn from mistakes and then move on to the next idea. And hopefully before too long, we'll have an exciting new product that will add to sales and profits.

What about innovation within the restaurants and the Made For You production system?

Made For You is a powerful concept that results in fresher, better-tasting food for our customers. Made For You combines advanced equipment, sophisticated computer technology and new operating procedures in the kitchen. Food is prepared to order for each customer. Somebody doesn't want pickles on a Big Mac or wants mustard on a grilled chicken sandwich? No problem. And since meals are prepared to order, food waste is reduced significantly. What's especially exciting is that this is far more than just an operating system. It provides a platform for food innovation because it makes it easier to serve a greater variety of products.

We have examples of restaurants in several U.S. markets that converted to Made For You during the test phase and are

Making A Difference

Innovation knows no boundaries, as demonstrated by owner/operator Ronald Monteiro.

When Ronald opened his first McDonald's in the Santos region of Brazil in 1992, he encountered children living in the doorway. They came from broken homes and—despite their young ages—were drug users.

Instead of becoming discouraged, he became their friend. Two years later, Ronald founded Associação Comunidade de Mãos Dadas, an organization of community businesses and local government, whose mission is to help these children.

That same year, Ronald, the local government and McDonald's jointly opened the first of four homes in the Santos region to provide refuge for these troubled children. These homes are staffed with teachers, doctors, dentists and others who care. They attempt to re-establish the children's family ties, provide an educational foundation and engage them in sports activities.

The results have been fabulous. Many kids who frequented the first home when it opened are now living with family members. Yet, they visit regularly for the support and encouragement that's waiting for them. More importantly, the children are off the streets. Ever the innovator, Ronald encourages others to make a difference, too. Today, two of his fellow franchisees in Brazil are using his homes as a model to help kids in their own communities.

Muito obrigado, Ronald.

doing very well today. The managements of these restaurants are using the system properly. Their people practices are right. They're aggressive about price, and they've remodeled and redecorated their physical facilities, if needed.

The reality is no single thing will drive this business. But in combination, innovative ideas and good people practices are going to keep our business growing. So these are two areas on which we are intensifying our focus.

"I truly believe that our owner/operators around the world represent a real competitive advantage. Because our success is dependent on their success, we work together to make McDonald's succeed."
Jack Greenberg

What opportunities does McDonald's have to share ideas among markets?

The opportunities are tremendous. For years, Jim Cantalupo and his team were successful in taking the formula that worked well in the U.S. and exporting it all over the world.

There also are opportunities to benefit from some tough lessons learned in the U.S. For example, we used to add 300 to 400 restaurants a year, every year, in the U.S. regardless of circumstances. It was a strategy that created a gap between us and the competition in terms of size. Looking back, we could have built even more U.S. restaurants at a time when our competition wasn't so great. So, a lot of those "other" restaurants could have been McDonald's. We've applied this lesson to our rapidly growing international business, especially in markets where the competition isn't strong. And our size and infrastructure enable us to offer quality and value that are increasingly difficult for competitors or potential competitors to match. This valuable lesson has helped strengthen our leadership position.

Now, McDonald's is tapping into the power of what I call a "global mindset." We're sharing ideas, best practices and human resources across borders more aggressively.

What makes McDonald's so special to people around the world?

I believe it is the power of Brand McDonald's. Why else were there 50,000 people trying to get into the new McDonald's in Belarus? Why was there a seven-mile drive-thru line in Kuwait when we opened?

We've done market research with our customers, and it's gratifying to see the enormous depth and breadth of the McDonald's brand. Customers say we have equities in products like the Big Mac, our World Famous Fries and the Egg McMuffin. Equities in our relationship with families and children with icons like Happy Meals, PlayPlaces, Ronald McDonald and Extra Value Meals. And equities in our community involvement, especially through Ronald McDonald Houses. Customers really relate to the overall McDonald's restaurant experience. All of this helps us develop brand-loyal customers. Just watch the faces of children when they walk into McDonald's; that's the power of Brand McDonald's. We also asked customers about our competitors' brands, and their list was much shorter and lacked the same emotional connection.

Running a corporation with such a broad reach, how do you keep in touch with so many markets?

I surround myself with really talented people and let them do their jobs. Our senior management is out and about all of the time, talking to owner/operators, restaurant managers and customers—getting a sense of what's going on in the field. We run a highly decentralized operation, both in the U.S. and internationally.

It's not practical for any single person to run this business. This is all about teamwork. But it's also important that people at all levels, including me, are held accountable for their decisions, actions and results. Our mission is to make sure we're running this business in the best interest of all our investors.

By investors, do you mean just shareholders?

Our shareholders are a very critical constituency, and I have special obligations to them. But they are not our only investors. Our investors include our owner/operators, who invest capital, time and energy. They also need to benefit. Many of our employees are shareholders; they are also investing their time, energy and futures with the Company. Even our suppliers are among our investors because they are investing time and capital to do business with McDonald's.

Why are franchisees so important to McDonald's?

Our franchisees, or owner/operators as we often call them, are the closest to our customers. They own and operate about 80 percent of our restaurant businesses. It's important that we are aligned, and I think we're more aligned today than at any time in recent memory.

Sharing McDonald's Vision

Jim Cantalupo, left, and Alan Feldman share their views on McDonald's International and U.S. businesses today and the prospects for the future.

"McDonald's people, with their shared vision of excellence, will lead the Company into the next century," noted Jack Greenberg.

Jim Cantalupo, vice chairman, McDonald's Corporation and chairman and chief executive officer—McDonald's International, and Alan Feldman, president—McDonald's USA, share this vision. They, too, are dedicated to making McDonald's the best quick-service restaurant experience in the world. These men and their teams make many of the decisions that impact McDonald's business and, ultimately, us as customers.

Jim's enthusiasm for the business is contagious. He emphasizes that, "We've extended McDonald's international presence to encompass more than 12,000 restaurants in 114 countries by providing customers with great quality, service, cleanliness and value. I've seen our international operating income increase more than eightfold during my watch, and I expect international to become an increasingly larger contributor to profits.

"McDonald's is the value leader in virtually every market, and customer demand for the McDonald's experience remains strong."
Jim Cantalupo

"We've been able to extend our leadership position due to the efforts of our many talented people around the world—from restaurant and office staffs to the men and women who are the managing directors of McDonald's businesses in their countries.

"Serving as a strategic link between each country's management and the home office are key members of my management team: Win Christiansen, Ron Cohen, Tim Fenton, Andreas Hacker, Robbin Hedges, Paul Preston, Peter Ritchie, Bill Rose, Ed Sanchez, Jim Skinner and Marvin Whaley. Each is responsible for a distinct area of the world, such as Latin America, Central Europe and Greater China, providing strategic direction and a channel for ongoing feedback.

"Together, they oversee the opening of more than 1,500 McDonald's annually. And we expect to do that for a long time because of the demand for our products around the world.

"Granted, there will be economic setbacks and external challenges, but our diverse revenue and operating income mix allows us to weather regional economic issues better than most and emerge even stronger. In addition, our global infrastructure provides a competitive advantage that is invaluable and extremely difficult to replicate.

"Our international business overcame some tough challenges in 1998 and reported strong results once again. McDonald's is the value leader in virtually every market, and customer demand for the McDonald's experience remains strong. We will continue to focus on value and profitable expansion to help us widen the gap against the competition. Long term, we have enormous opportunity to build our already substantial sales, profits and returns in the international marketplace. And that's exactly what we plan to do."

"...satisfied customers are the force that will continue to drive increases in sales and profits."
Alan Feldman

Alan and his management team have begun to reinvigorate the U.S. business and are committed to build on that momentum. His excitement for and confidence in the business are evident. He readily points out, "The System is already beginning to see the tangible results of focusing on our strategies of delivering operational excellence, providing customers with the best value in the quick-service restaurant business and fostering a motivating environment for our owner/operators and employees. In 1998, we increased restaurant sales, profits, returns and owner/operator cash flow in the U.S. We also increased our market share in the growing hamburger segment of the quick-service restaurant industry to the highest level it's been in this decade.

"I attribute a lot of our success in 1998 to our owner/operators and restaurant staffs across the country and to the leadership provided by our five U.S. division presidents: John Charlesworth, Kevin Dunn, Henry Gonzalez, Debra Koenig and Mike Roberts. Each of these individuals is responsible, and accountable, for roughly $3.6 billion of System sales annually, making decisions regarding marketing, franchising, site development and restaurant operations in their respective divisions.

"I am also proud of the strong support demonstrated by our U.S. franchisees for our Made For You food preparation system. Their commitment reinforces the effectiveness of this system, which provides customers with fresher food, reduces restaurant operating costs and strategically supports our efforts to optimize food taste and accommodate more menu variety.

"Looking forward, we will relentlessly pursue customer satisfaction, as satisfied customers are the force that will continue to drive increases in sales and profits."

Jack—not shy about his admiration for his colleagues—was quick to add, "Jim has done an extraordinary job of building the international business over the last 11 years. And Alan's impact on the business, as an architect and agent for change, has earned him the respect and admiration of owner/operators and employees alike. We are lucky to have their skill sets; the results have been fabulous."

I truly believe that our owner/operators around the world represent a real competitive advantage. Because our success is dependent on their success, we work together to make McDonald's succeed. Their input is integral to maintaining our leadership position. When you think of it that way, it's easy to understand why we are so committed to franchising as a way of doing business.

Will McDonald's ever diversify beyond the "Golden Arches?"

Ninety-nine percent of our efforts must be to grow the business called McDonald's. That's our first priority, our second priority and our third priority. But we are good at a great many things. I think that, over time, we owe it to our shareholders, our owner/operators, our employees and our suppliers to see how we can take advantage of our skills and competencies. In my mind, this is not diversification. This is a natural expansion.

We know how to run a multi-unit restaurant business at a high-quality standard. We know how to train people, how to buy real estate and construct buildings, and how to market products. And together with our suppliers, we have a unique global supply infrastructure. If we can find a way to leverage this for the long run, then we must try.

But as I already said, our first, second and third priorities are the Golden Arches.

Describe your management style? Who influenced you?

My management style is rooted in my strong belief that leaders cast a long shadow in how they behave with individuals day to day. This has been my own experience. It's not just how you act when you're giving a speech in front of a thousand people; it's how you act in a meeting with three or four people. I believe how leaders deal with the people they touch has an enormous impact on how organizations ultimately behave.

I think all of us are the result of so many different experiences and influences. For instance, I remember one of my college professors saying one day that having "connections" wasn't the only way to get ahead. Rather, he said, "Somebody has to do the work in a quality way."

Then there was the late Gerry Newman, who was McDonald's chief accounting officer for many years. Gerry taught me the value of listening and that our relationship with our owner/operators was both important and sensitive. He was a special mentor for me. There's also Fred Turner, our senior chairman. Fred pioneered this business along with our founder Ray Kroc. They taught me to value creativity and innovation. And our chairman Mike Quinlan's mantra to "never be satisfied" serves as a constant reminder that while we should take time to enjoy our successes, we must always try to do even better in the future.

What key goals have you set for yourself as CEO?

I would love to see McDonald's ranked even higher on the list of the most admired companies in the world. A company that provides the highest customer satisfaction, opportunities for all the people who work here—and great returns for both our owner/operators and our shareholders.

Treating People Right

People development has been given a heightened emphasis at McDonald's, starting with restaurant staffs. Clearly, customer satisfaction starts with employee satisfaction. So, it's important that people around the world working at McDonald's are treated right and are given the training and the opportunity to succeed.

Cathie Habiger, an owner/operator with four McDonald's in the Kansas City region, has embraced this philosophy, creating a win-win-win situation for her employees, her customers and her business.

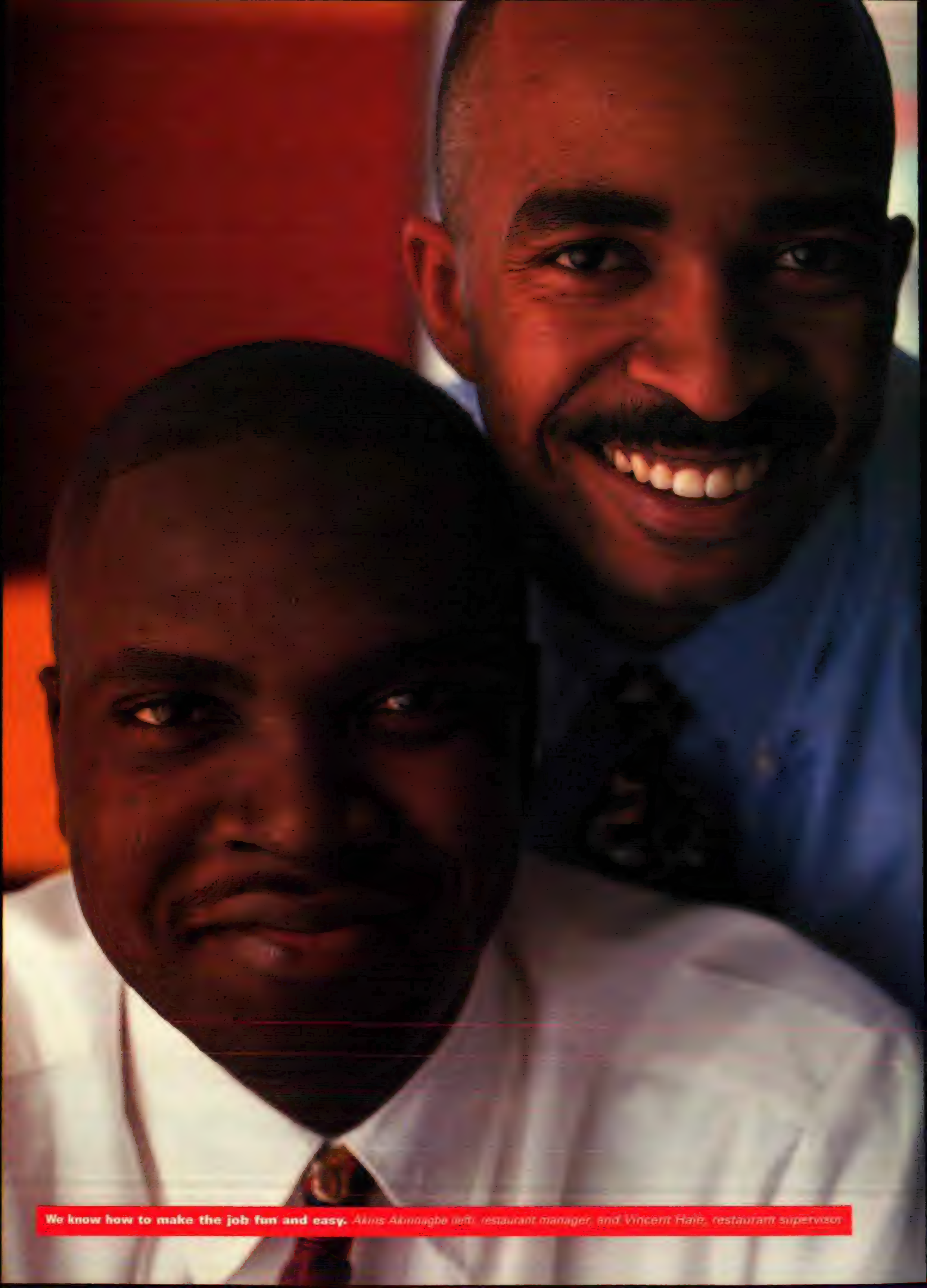
Faced with high employee turnover, Cathie identified opportunities for positive change. She introduced special training to enhance the people, business and management skills of her part-time managers. This generated greater self-confidence among them and more enthusiasm among full-time managers for special training for themselves. Also, with part-time managers better able to effectively run restaurants, her full-time managers can focus on crew training and providing the extra attention their crews sometimes need.

Cathie also is helping her managers and crews to become business partners through monetary incentives tied to her organization's performance. And she is attracting higher quality high-school students as crew by providing financial awards for good grades.

Her efforts have been rewarded. She has reduced employee turnover and improved profitability. Cathie also has better trained and motivated employees at all levels satisfying her customers.

McDonald's serves 40 million customers a day. Someone's doing something right.

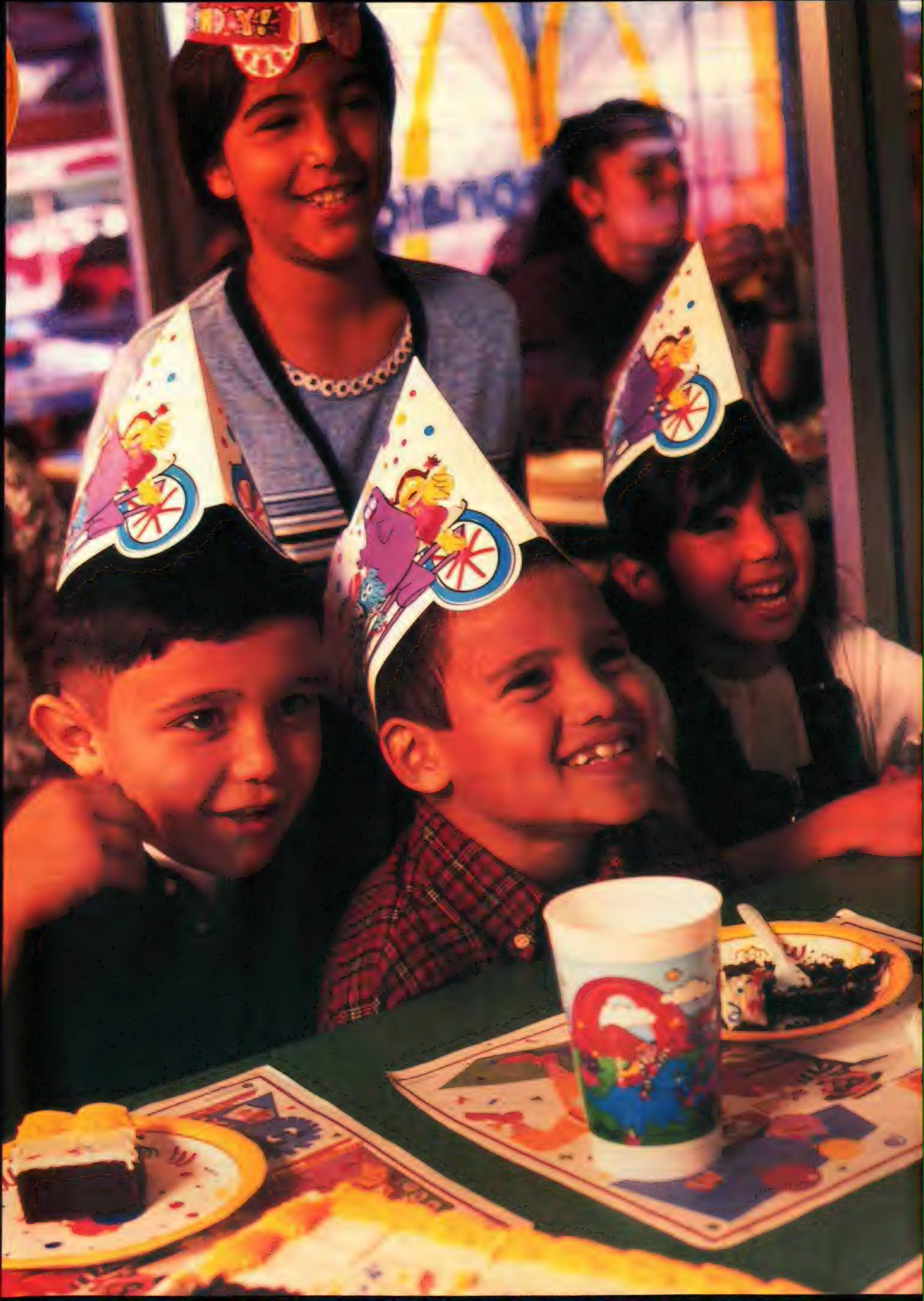

McDonald's really is family to me. *Lino Lopez, greeter*


We know how to make the job fun and easy. *Akins Akinnagbe (left), restaurant manager, and Vincent Hale, restaurant supervisor*

McDonald's is my first and only job.
Eva Wong, crewperson

We are McDonald's "eggsolutions" expert!
Jerry Rose, supplier

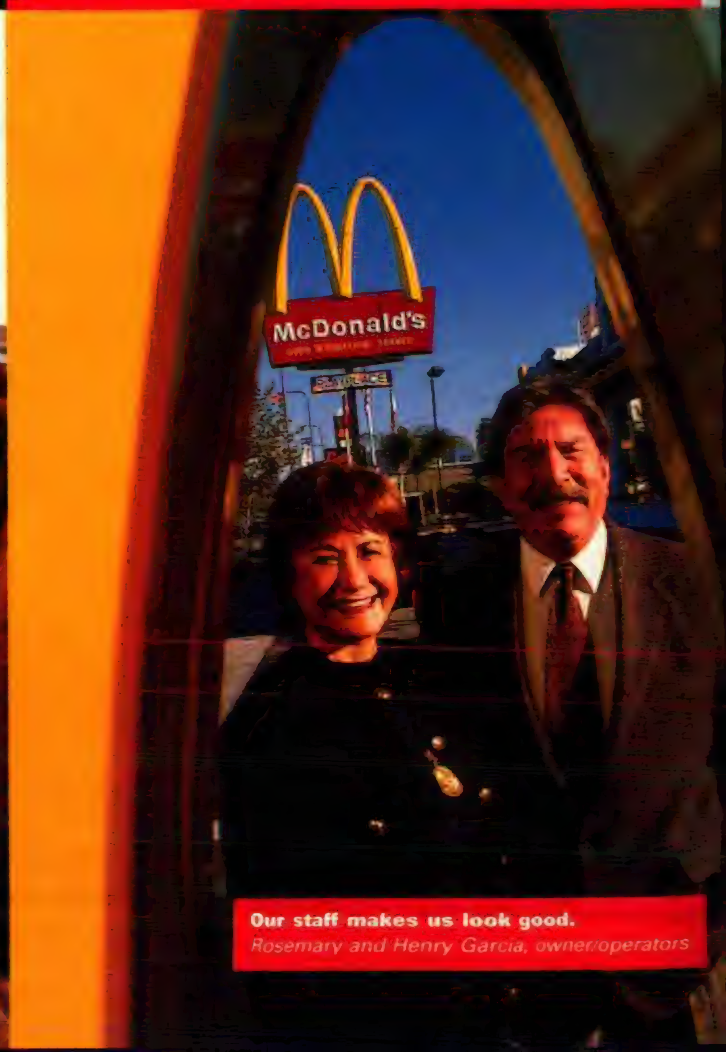

I want my *next* birthday party at McDonald's, too! Matthew Avila, birthday boy
McDonald's



McDonald's is constant change. Change is good!
Eric Hillesland, northeast operations

My folks are hoping my McDonald's stock will pay for college!
Jamie Karl, shareholder

I've been so inspired by the families I've met here.
Janet Burton, Ronald McDonald House volunteer



Our staff makes us look good.
Rosemary and Henry Garcia, owner/operators

McDonald's makes a great family outing. *The Concepcion Family, customers*

CFO Review by Mike Conley

I'd like to talk to you about what McDonald's is doing to increase the value of your investment in the Company.

Our goal is to manage new and existing investments so that every dollar invested contributes to increases in shareholder value.

For existing assets, our focus is on building comparable sales through operational excellence and innovation.

When evaluating investment opportunities, such as how many restaurants to open or whether to open in a new country, our decision is based on our ability to earn returns greater than our cost of capital. Exceeding our cost of capital means that we will be able to satisfy our debt holders as well as meet or exceed the higher return expectations of our shareholders. For each new opening considered, we project the expected sales and profits to determine if the returns are acceptable for both the Company and our owner/operators.

For some investments, the returns are achieved right away, and for others, it may take a little longer. But we invest to sustain long-term profitable growth. For example, initially our investment in the international business generated low returns, but over time has added enormous value.

McDonald's strong balance sheet allows us to borrow at attractive rates, helping to reduce the cost of capital, creating additional value.

A few years ago, in the U.S., as new restaurants opened with lower sales volumes, returns on these restaurants were declining. In light of this trend, we took action to improve these returns. First, we adopted a more selective expansion strategy. Secondly, for substantially all new U.S. restaurants, we are now leasing land (versus buying) and subleasing to our owner/operators. In addition, during 1998 we began testing a program that gave U.S. owner/operators the option to own new restaurant buildings versus leasing from the Company. This innovative approach is a "win/win" for our owner/operators and our shareholders. The owner/operators generally realize an increase in cash flow and add substantial value to their businesses long term. McDonald's still has long-term tenure in the land and receives related rental income.

In 1998, free cash flow totaled $887 million. As capital expenditures level off and cash from operations continues to increase, we expect free cash flow to continue to grow.

This approach increases our returns because of the more efficient capital deployment. The Company's avoided capital investment adds to cash flow and allows us to increase share repurchases.

Return on average assets increased to

16.4

percent

Excluding Made For You costs and special charge

As part of the process of managing existing assets, we continuously review our capital structure to ensure that we are maximizing shareholder value. As a result, we investigated various capital deployment alternatives, including REITs, for existing restaurant land and buildings. Based on our analysis to date, we believe the best way to continue our long-term profitable growth is to continue to own these assets and focus our efforts on driving higher returns by running great restaurants and building sales. Worldwide, the lower number of net openings in 1998 reflected our more selective expansion strategy as we continue to focus on building comparable sales, managing our capital outlays more effectively and increasing returns. We also closed a number of lower volume satellite restaurants, primarily in the U.S.

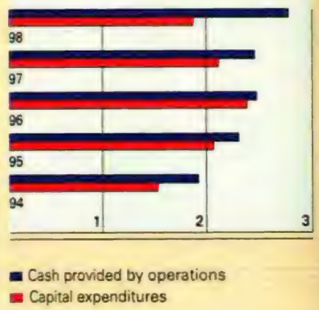
For international expansion, our unparalleled global infrastructure provides a competitive advantage that is difficult to replicate. Other businesses may leave a market or stop growing in difficult economies, while we continue to thoughtfully invest based on our long-term view of the opportunity.

We continue to leverage our global strengths and purchasing power to reduce operating costs worldwide. In addition, as we concentrate our growth in existing markets, we expect selling, general and administrative expenses as a percent of sales will continue to trend lower over time.

These factors enabled the international segment to fund $1.4 billion of capital expenditures in 1998 with cash from its operations for the first time. The U.S. has been self-financing for a number of years, and its free cash flow has been used to help fund international expansion.

In 1998, free cash flow totaled $887 million. As capital expenditures level off and cash from operations continues to increase, we expect free cash flow to continue to grow. We will use this growing free cash flow to add value through share repurchase and paying dividends. In addition, this free cash flow gives us the flexibility to develop other business and growth opportunities long term.

Cash flow and capital expenditures
In billions of dollars



We believe share repurchase is a great way to enhance shareholder value. In 1998, we purchased 38 million shares for $1.2 billion, of which 10.2 million shares for $320 million related to our new $3.5 billion share repurchase program. Over the past 10 years, we purchased $4.8 billion, or 306 million shares, of our stock and paid $1.7 billion in common stock cash dividends. We believe these actions will provide attractive long-term returns to shareholders.

To conclude, I believe that McDonald's ongoing focus on profitable growth and improving returns on average assets and invested capital, our strong U.S. and international businesses and our growing cash flow should continue to create shareholder value.

Analyzing Financial Performance

Consolidated operating results

In this report, all per share amounts have been restated to reflect the two-for-one stock split in March 1999. In addition, all information in constant currencies excludes the effect of foreign currency translation on reported results, except for hyperinflationary economies, such as Russia, whose functional currency is the U.S. dollar.

Operating results

(Dollars in millions, except per share data)	**1998** Amount	**1998** % Increase/ (decrease)	1997 Amount	1997 % Increase	1996 Amount
Systemwide sales	**$35,979**	**7**	$33,638	6	$31,812
Revenues					
Sales by Company-operated restaurants	**$ 8,895**	**9**	$ 8,136	7	$ 7,571
Revenues from franchised and affiliated restaurants	**3,526**	**8**	3,273	5	3,116
Total revenues	**12,421**	**9**	11,409	7	10,687
Operating costs and expenses					
Company-operated restaurants	**7,261**	**9**	6,650	8	6,163
Franchised restaurants	**678**	**10**	614	8	570
Selling, general and administrative expenses	**1,458**	**-**	1,451	6	1,367
Made For You costs	**162**	**n/m**	–	–	–
Special charges	**160**	**n/m**	–	n/m	72
Other operating (income) expense	**(60)**	**n/m**	(114)	n/m	(118)
Total operating costs and expenses	**9,659**	**12**	8,601	7	8,054
Operating income(1)	**2,762**	**(2)**	2,808	7	2,633
Interest expense	**414**	**14**	364	6	343
Nonoperating (income) expense	**41**	**n/m**	37	n/m	39
Income before provision for income taxes(1)	**2,307**	**(4)**	2,407	7	2,251
Provision for income taxes(1)	**757**	**(1)**	765	13	678
Net income(1)	**$ 1,550**	**(6)**	$ 1,642	4	$ 1,573
Net income per common share(1)	**$ 1.14**	**(3)**	$ 1.17	5	$ 1.11
Net income per common share-diluted(1)	**1.10**	**(4)**	1.15	6	1.08

(1) The 1998 results include $162 million of Made For You costs and the $160 million special charge, discussed on page 24, for a pre-tax total of $322 million ($219 million after tax or $0.16 per share). The 1996 results include the $72 million pre-tax special charge and a $50 million tax benefit resulting from certain international transactions, discussed on pages 24 and 26.

n/m = not meaningful

Operating results ***(excluding Made For You costs and special charges)***

(Dollars in millions, except per share data)	**1998** Amount	**1998** % Increase	1997 Amount	1997 % Increase	1996 Amount
Operating income	**$3,084**	**10**	$2,808	4	$2,705
Net income	**$1,769**	**8**	$1,642	4	$1,573
Net income per common share	**$ 1.30**	**11**	$ 1.17	5	$ 1.11
Net income per common share-diluted	**1.26**	**10**	1.15	6	1.08

The spreads between the percent change in net income and net income per common share reflected the positive effects of share repurchases and the absence of preferred dividends in 1998, due to the retirement of our remaining Series E Preferred Stock in December 1997, and lower preferred dividends in 1997 compared with the prior year.

The following table presents the reported and constant currency results for 1998 and 1997, excluding Made For You costs and special charges:

(Dollars in billions, except per share data)	As reported **1998**		As reported 1997		In constant currency **1998**		In constant currency 1997	
Systemwide sales	**$36.0**	**7%**	$33.6	6%	**$37.0**	**10%**	$35.0	10%
Revenues	**12.4**	**9**	11.4	7	**12.8**	**12**	11.8	11
Operating income	**3.1**	**10**	2.8	4	**3.2**	**12**	2.9	8
Net income	**1.8**	**8**	1.6	4	**1.8**	**10**	1.7	8
Net income per common share	**1.30**	**11**	1.17	5	**1.33**	**14**	1.21	9
Net income per common share-diluted	**1.26**	**10**	1.15	6	**1.29**	**12**	1.19	10

Systemwide sales

Systemwide sales include sales by all restaurants, whether operated by the Company, by franchisees or by affiliates operating under joint-venture agreements. Increasing market share through expansion, and customer satisfaction through quality, service, cleanliness and value continue as key strategic initiatives to build sales. Sales increases in 1998 and 1997 were primarily due to restaurant expansion and positive comparable sales (measured on a constant currency basis), partly offset by weaker foreign currencies. At the end of 1998, 86% of Systemwide sales were in the following 11 markets—Australia, Brazil, Canada, England, France, Germany, Hong Kong, Japan, the Netherlands, Taiwan and the U.S. (major markets based on operating income). This is down slightly from 87% in 1997.

Sales increases in the U.S., Europe and Latin America were driven by expansion and positive comparable sales in 1998 and 1997. In the U.S., successful Monopoly, Teenie Beanie

Babies, Get Back With Big Mac and Disney promotions, combined with local market initiatives, contributed to the 1998 increase. In Europe, performances benefited from value campaigns and successful promotions in England, France and Germany. Europe's results were reduced by the difficult economic conditions in Russia in the last half of 1998. In Latin America, Argentina and Brazil accounted for approximately half of this segment's total sales growth in both years, mainly due to expansion.

In Asia/Pacific, sales decreased in 1998 due to weaker foreign currencies and negative comparable sales. Excluding the translation effect of weaker foreign currencies, Japan realized strong sales growth despite experiencing its most difficult economy in decades. In addition, Australia's sales improved due to positive comparable sales in the last half of the year. Difficult economic conditions in Southeast Asia, which began in the latter part of 1997 and continued throughout 1998, negatively impacted consumer spending. In 1997, sales increased primarily due to expansion.

(In millions)	**1998**	1997	1996	1995	1994
U.S.	**$18,123**	$17,125	$16,370	$15,905	$14,941
Europe	**8,909**	7,835	7,377	6,685	5,211
Asia/Pacific	**5,579**	5,616	5,349	4,835	3,795
Latin America	**1,761**	1,511	1,273	1,129	794
Other	**1,607**	1,551	1,443	1,360	1,246
Systemwide sales	**$35,979**	$33,638	$31,812	$29,914	$25,987

Sales by Company-operated restaurants grew at a higher rate than Systemwide sales in 1998 and 1997, primarily due to the higher unit growth rate of Company-operated restaurants outside the U.S. relative to Systemwide restaurants. In addition, the weakened Japanese Yen had a significant negative effect on our Japanese affiliate's sales, which reduced Systemwide sales growth.

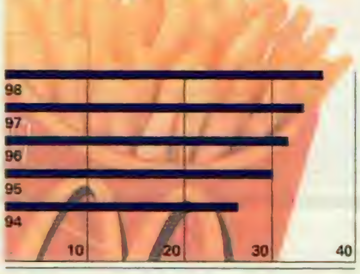
Average annual sales per restaurant[1]

(In thousands)	**1998**	1997	1996
U.S.			
Traditional	**$1,584**	$1,523	$1,530
Satellite	**459**	445	425
Outside the U.S.			
Traditional	**1,801**	1,966	2,262
Satellite	**450**	457	488

(1) Restaurants in operation at least 13 consecutive months

Average sales are affected by several factors: comparable sales and the size and number of new restaurants. The number of new restaurants affects average sales as new restaurants historically have taken a few years to reach long-term volumes. In addition, over the last several years we have opened more restaurants in lower density areas and countries with lower average sales volumes. For these reasons, our focus is primarily on sales-to-investment ratios and building comparable sales, rather than on average sales.

Systemwide sales
In billions of dollars



In 1998, positive comparable sales drove the increases in U.S. average annual sales per restaurant. Outside the U.S., foreign currency translation accounted for approximately half of the decreases in average annual sales in both 1998 and 1997. In addition, the significant number of new restaurants outside the U.S. negatively impacted the averages.

Average annual sales per new restaurant[1]

(In thousands)	**1998**	1997	1996
U.S.			
Traditional	**$1,332**	$1,237	$1,206
Outside the U.S.			
Traditional	**1,357**	1,431	1,710
Satellite	**446**	453	517

(1) Restaurants in operation at least 13 months but not more than 25 months

In 1998 and 1997, the increases in sales per new U.S. traditional restaurant were due to a more selective expansion strategy. In addition, in 1998, larger facilities supported higher average sales. The decreases in sales per new restaurant outside the U.S. in 1998 and 1997 were due to foreign currency translation and expansion. Excluding foreign currency translation, the 1998 average annual sales for new international traditional and satellite restaurants increased to $1,439,000 and $479,000, respectively. Satellite restaurants generally have significantly lower development costs and sales volumes than traditional restaurants. Average annual sales per new traditional restaurant in major markets outside the U.S., excluding Japan, were approximately $1.7 million in 1998 and 1997.

Total revenues

Total revenues include sales by Company-operated restaurants and fees from restaurants operated by franchisees and affiliates. These fees include rent, service fees and royalties that are based on a percent of sales with specified minimum payments along with initial fees. Fees vary by type of site and investment by the Company, and also according to local business conditions. These fees, along with occupancy and operating rights, are stipulated in franchise agreements that generally have 20-year terms.

Revenues grow as new restaurants are added and as sales build in existing restaurants. Menu price changes also affect revenues and sales, but it is impractical to quantify their impact because of different pricing structures, new products, promotions and product-mix variations among restaurants and markets.

Revenues increased at a faster rate than Systemwide sales in 1998 and 1997. This was primarily due to the weakened Japanese Yen, which negatively affected sales more than revenues due to our affiliate structure in Japan, and the higher unit growth rate of Company-operated restaurants outside the U.S. relative to Systemwide restaurants.

U.S. revenues increased $265 million in 1998 and $13 million in 1997. The increased revenue growth in 1998 was primarily due to strong sales performance for both Company-operated and franchised restaurants driven by positive comparable sales and expansion. Lower initial fees resulting from fewer openings partly offset the increase in revenues. The slower revenue growth in 1997 was primarily because the number of U.S. Company-operated restaurants decreased

compared with the prior year, while the number of franchised and affiliated restaurants increased. Lower initial fees also contributed to the slower revenue growth in 1997.

U.S. operating results
(excluding Made For You costs and special charges)

(In millions)	**1998**	1997	1996	1995	1994
Revenues					
Sales by Company-operated restaurants	**$2,829**	$2,691	$2,776	$2,725	$2,550
Revenues from franchised and affiliated restaurants	**2,039**	1,912	1,814	1,749	1,606
Total revenues	**4,868**	4,603	4,590	4,474	4,156
Operating costs and expenses					
Company-operated restaurants	**2,338**	2,246	2,317	2,244	2,066
Franchised restaurants	**389**	361	334	304	270
Selling, general and administrative expenses	**750**	788	740	682	628
Other operating (income) expense	**25**	(3)	(17)	(8)	(25)
Total operating costs and expenses(1)	**3,502**	3,392	3,374	3,222	2,939
U.S. operating income(1)	**$1,366**	$1,211	$1,216	$1,252	$1,217

(1) The1998 results exclude $162 million of Made For You costs and the $160 million special charge for a pre-tax total of $322 million. The 1996 results exclude the $72 million pre-tax special charge.

Europe accounted for 36% of consolidated revenues in 1998 and 34% in 1997. This region's revenues grew $535 million and $318 million in 1998 and 1997, respectively. The increases were driven by strong sales in England, France and Germany in 1998 and in England, Italy and Russia in 1997.

Asia/Pacific's revenues grew $110 million in 1998, compared with growth of $250 million in 1997. In constant currencies, these increases were $341 million in 1998 and $318 million in 1997. Due to an increase in ownership, several affiliate markets were consolidated for financial reporting purposes in 1998. This contributed to the revenue increase. The consolidation of Singapore in 1997, along with Taiwan's strong results, helped to advance 1997 revenues. Difficult economic conditions in Southeast Asia, which began in the latter part of 1997 and continued throughout 1998, dampened revenue growth in both years.

Operating results outside the U.S.

(In millions)	**1998**	1997	1996	1995	1994
Revenues					
Sales by Company-operated restaurants	**$6,066**	$5,445	$4,795	$4,139	$3,242
Revenues from franchised and affiliated restaurants	**1,487**	1,361	1,301	1,182	923
Total revenues	**7,553**	6,806	6,096	5,321	4,165
Operating costs and expenses					
Company-operated restaurants	**4,923**	4,404	3,846	3,304	2,579
Franchised restaurants	**289**	253	236	211	165
Selling, general and administrative expenses	**632**	601	574	507	408
Other operating (income) expense	**(85)**	(111)	(101)	(98)	(59)
Total operating costs and expenses	**5,759**	5,147	4,555	3,924	3,093
Operating income outside the U.S.	**$1,794**	$1,659	$1,541	$1,397	$1,072

Latin America's revenues grew $105 million in 1998 and $114 million in 1997. Growth in both years was primarily due to expansion in Brazil and positive comparable sales for the segment.

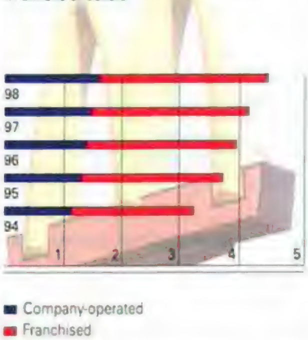
Company-operated margins

Company-operated margin dollars are equal to sales by Company-operated restaurants less the operating costs of these restaurants. Consolidated Company-operated margin dollars increased $148 million or 10% in 1998 and $78 million or 6% in 1997. The increases were primarily driven by expansion, partly offset by weaker foreign currencies. In addition, positive comparable sales contributed to the increase in 1998.

Consolidated Company-operated margins were 18.4% of sales in 1998, 18.3% in 1997 and 18.6% in 1996. Operating cost trends as a percent of sales were as follows: food & paper costs decreased in 1998 and increased in 1997; payroll costs were flat in 1998 and decreased in 1997; and occupancy & other operating costs increased in both years.

U.S. Company-operated margins were 17.3% of sales in 1998 and 16.5% in 1997 and 1996. Increased margins as a percent of sales in 1998 were driven by lower food & paper costs related primarily to decreased commodity costs, partly offset by higher payroll costs related to an increase in average hourly rates. Occupancy & other operating costs were flat. U.S. Company-operated margins as a percent of sales in 1997 reflected higher food & paper costs related primarily to the Deluxe Line, lower payroll costs related to labor efficiencies and lower occupancy & other operating costs.

Combined operating margins
In billions of dollars



Company-operated margins outside the U.S. were 18.8% of sales in 1998, compared with 19.1% in 1997 and 19.8% in 1996. In 1998, increases in occupancy & other operating costs as a percent of sales were the primary cause of the margin decline as payroll costs and food & paper costs were flat as a percent of sales. The decline in the 1997 margin as a percent of sales was due to increases in food & paper costs as well as occupancy & other operating costs, partly offset by a decrease in payroll costs. Weaker foreign currencies put pressure on margins outside the U.S. in both 1998 and 1997, as food & paper costs were negatively affected in those markets where we imported products.

Franchised margins

Franchised margin dollars are equal to revenues from franchised and affiliated restaurants less the Company's occupancy costs (rent and depreciation) associated with these sites. Franchised margin dollars represented more than 60% of the combined operating margins in both 1998 and 1997. Consolidated franchised margin dollars increased $189 million or 7% in 1998 and $113 million or 4% in 1997. The increases were primarily driven by expansion, partly offset by weaker

Net income per common share–diluted
In dollars

*Excludes Made For You costs and special charge.

foreign currencies. In addition, positive comparable sales contributed to the increase in 1998.

Consolidated franchised margins were 80.8% of applicable revenues in 1998, 81.2% in 1997 and 81.7% in 1996. Franchised margins in the U.S. were 80.9% of revenues in 1998, 81.1% in 1997 and 81.6% in 1996. Outside the U.S., franchised margins were 80.6% of revenues in 1998, 81.4% in 1997 and 81.8% in 1996.

The 1998 and 1997 declines reflected a higher proportion of leased sites, and in the U.S. also reflected lower initial fees resulting from fewer openings. By leasing a higher proportion of new sites over the past few years, we have reduced initial capital requirements, but negatively affected franchised margins as a percent of applicable revenues. This is because financing costs implicit in the lease are included in rent expense, which affects these margins; for owned sites, financing costs are reflected in interest expense, which does not affect these margins. Also, our decision to increase our ownership in several affiliate markets in 1998 and 1997 shifted revenues from franchised and affiliated restaurants to Company-operated restaurants, reducing the franchised restaurant margins outside the U.S.

Selling, general and administrative expenses

Consolidated selling, general and administrative expenses were relatively flat in 1998 and decreased to 4.1% of sales from 4.3% of sales in 1997 and 1996. In 1998, U.S. selling, general and administrative expenses decreased primarily due to lower advertising costs and savings realized from the home office productivity initiative, partly offset by higher performance-based incentive compensation. Outside the U.S., selling, general and administrative expenses increased, due to support of restaurant development and to a lesser extent, from the consolidation of several affiliate markets for financial reporting purposes, partly offset by weaker foreign currencies. In 1997, consolidated selling, general and administrative expenses increased primarily due to continued investment in developing countries and the support of special marketing efforts and new food initiatives in the U.S., partly offset by weaker foreign currencies.

As a result of the home office productivity initiative, the Company expects to save about $100 million of selling, general and administrative expenses per year, beginning in 2000, with about two-thirds of the annual savings expected to be realized by the end of 1999. About $15 million of these savings were realized in 1998.

Made For You costs

In 1998, the Company announced the introduction of Made For You, a new food preparation system that is expected to be installed in virtually all restaurants in the U.S. and Canada by the end of 1999. Through advances in equipment and technology, the new system allows us to serve fresher, better-tasting food at the speed of McDonald's. The system also supports future growth through product development because it can more easily accommodate an expanded menu. The Company is providing financial incentives of up to $12,500 per restaurant to owner/operators to defray the cost of equipment made obsolete as a result of converting to the new system. The Company is also making additional payments in special cases where the conversion to Made For You is more extensive.

In 1998, the Company incurred $162 million in Made For You costs, which primarily consisted of nonrefundable incentive payments made to owner/operators as well as accelerated depreciation on equipment being replaced in Company-operated restaurants. The Company expects the total costs related to the implementation of Made For You to approximate $190 million. The remaining costs are expected to be incurred by the end of 1999, and are comprised of about $15 million of incentive payments and $15 million of accelerated depreciation.

Special charges

In second quarter 1998, the Company recorded a $160 million pre-tax special charge related to the results of the Company's home office productivity initiative. This initiative is designed to improve staff alignment, focus and productivity and reduce ongoing selling, general and administrative expenses. As a result, the Company is reducing home office staffing by approximately 525 positions, consolidating certain home office facilities and reducing other expenditures in a variety of areas. The special charge was comprised of $85.8 million of employee severance and outplacement costs, $40.8 million of lease cancellation and other facilities-related costs, $18.3 million of costs for the write-off of capitalized technology made obsolete as a result of the productivity initiative, and $15.1 million of other cash payments made in 1998. Employee severance is paid in semi-monthly installments over a period of up to one year after termination.

As of December 31, 1998, the Company had reduced home office staffing by approximately 400 positions and expects the remaining positions to be eliminated by year-end 1999. The remaining accrual, primarily related to employee severance, was approximately $105 million at December 31, 1998. No significant adjustments have been made to the original plan approved by management in second quarter 1998. The Company expects to use cash provided by operations to fund the remaining severance payments and other cash costs related to the productivity initiative.

In 1996, the Company recorded a $72 million pre-tax special charge related primarily to plans to strengthen the U.S. business and reduce ongoing costs by closing low-volume U.S. satellite restaurants, outsourcing excess property management and implementing other cost efficiencies. The actions required by this plan were completed in 1997 and resulted in no significant adjustments to the original cost estimate.

Other operating (income) expense

Other operating (income) expense includes gains on sales of restaurant businesses, equity in earnings of unconsolidated affiliates, net gains or losses from property dispositions and other transactions related to the food service business.

Gains on sales of restaurant businesses include gains from sales of Company-operated restaurants as well as gains from exercises of purchase options by franchisees with business facilities lease arrangements (arrangements where the Company leases the businesses, including equipment, to owner/operators who have options to purchase the businesses). The Company's purchases and sales of businesses with its franchisees and affiliates are aimed at achieving an optimal ownership mix in each market. These transactions are an integral part of our franchising business and resulting gains are recorded in operating income.

Equity in earnings of unconsolidated affiliates—businesses the Company actively participates in, but does not control—is reported after interest expense and income taxes, except for U.S. restaurant partnerships, which are reported before income taxes.

Net gains or losses from property dispositions result from disposals of properties due to restaurant closings, relocations and other transactions.

Other operating (income) expense decreased in 1998, primarily due to higher provisions for property dispositions that reflected an increased number of restaurant closings. These expenses were partly offset by higher gains on sales of restaurant businesses and increased equity in earnings of unconsolidated affiliates, due to strong performances in Japan and the U.S. The slight decline in other operating (income) expense in 1997 was primarily due to lower equity in earnings of unconsolidated affiliates and lower gains on sales of restaurant businesses, partly offset by lower provisions for property dispositions.

Operating income

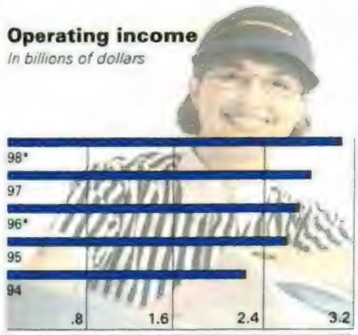
Excluding Made For You costs and the special charges, operating income increased $276 million or 10% to $3.1 billion in 1998, and $103 million or 4% to $2.8 billion in 1997. In constant currencies, these increases were 12% in 1998 and 8% in 1997. The increases in 1998 and 1997 were primarily due to higher combined operating margin dollars, partly offset by weaker foreign currencies and lower other operating (income) expense. In addition, higher selling, general and administrative expenses negatively affected the 1997 increase. Including Made For You costs and the special charges, operating income decreased 2% in 1998 and increased 7% in 1997.

Operating income in 1998 and 1997 from the major markets accounted for 92% of total operating income, excluding 1998 Made For You costs and the special charge.

U.S. operating income rose $155 million or 13% in 1998 and was flat in 1997, excluding Made For You costs and special charges. In 1998, higher U.S. combined operating margin dollars and lower selling, general and administrative expenses were offset in part by lower other operating (income) expense. In 1997, higher U.S. franchised margin dollars were offset by lower Company-operated margin dollars and higher selling, general and administrative expenses. Including Made For You costs and special charges, U.S. operating income decreased $167 million or 14% in 1998 and increased $67 million or 6% in 1997.

Outside the U.S., operating income rose $135 million or 8% in 1998 and $118 million or 8% in 1997. In constant currencies, these increases were 12% in 1998 and 15% in 1997. This growth was driven by higher combined operating margin dollars resulting from expansion in both years and slightly positive comparable sales in 1998. In both years, weaker foreign currencies and higher selling, general and administrative expenses partly offset these increases. In 1998, the Australian Dollar, Brazilian Real, Canadian Dollar, Japanese Yen and Russian Ruble, as well as the Southeast Asian currencies, were the primary currencies negatively affecting results.

Europe accounted for 41% and 36% of consolidated operating income in 1998 and 1997, respectively. Europe's operating income grew $133 million in 1998 compared with $54 million in 1997. Weaker currencies offset this region's operating income increase in 1998 by only 1% or $6 million, and by 9% or $82 million in 1997. Strong operating results in England, France, Germany, Italy and Spain drove the increase in operating income in 1998. The region's results were negatively affected by the difficult economic conditions in Russia, which are expected to continue in 1999. England, France and Germany accounted for 77% of Europe's operating income in both 1998 and 1997.



*Excludes Made For You costs and special charges

Asia/Pacific's operating income declined $18 million in 1998 compared with an increase of $14 million in 1997. The decline in 1998 was primarily due to weaker foreign currencies. On a constant currency basis, Asia/Pacific's operating income would have increased $29 million in 1998 and $38 million in 1997. In 1998, Japan and Hong Kong had strong operating results despite the difficult economic conditions that were experienced by much of the region beginning in the latter part of 1997 and continuing throughout 1998. In addition, this segment benefited in both years from the financial reporting consolidation of several affiliate markets. Australia, Hong Kong, Japan and Taiwan contributed about 90% of Asia/Pacific's operating income in both years.

Latin America's operating income increased $18 million in 1998 and $53 million in 1997. Argentina, Brazil and Venezuela led this region's increase in 1998. Continued expansion and positive comparable sales drove improved results across this segment in 1998 and 1997. Brazil accounted for about 70% of Latin America's operating income in both years. The recent economic turmoil in Brazil is expected to negatively impact operating results in 1999. The Latin America segment represented 7% of consolidated operating income in 1998.

Interest expense

Higher average debt levels, partly offset by weaker foreign currencies and lower average interest rates, accounted for the 1998 and 1997 increases in interest expense.

Nonoperating (income) expense

Nonoperating (income) expense includes miscellaneous income and expense items such as interest income and gains and losses related to other investments, financings and translation. Results in 1998 reflected translation losses compared with translation gains in 1997, while in 1997 interest income and translation gains were lower than in 1996.

Provision for income taxes

The effective income tax rate was 32.8% for 1998, compared with 31.8% for 1997 and 30.1% for 1996. A $50 million tax benefit resulting from certain international transactions was primarily responsible for the unusually low tax rate in 1996. The Company expects its 1999 effective income tax rate to be in the range of 32.5% to 33.5%.

Consolidated net deferred tax liabilities included tax assets, net of valuation allowance, of $516 million in 1998 and $451 million in 1997. Substantially all of the tax assets arose in the U.S. and other profitable markets, and a majority of them are expected to be realized in future U.S. income tax returns.

Restaurants

McDonald's continues to focus on managing capital outlays more effectively through prudent and strategic expansion. In 1998, the Company added 1,668 restaurants Systemwide, compared with 2,110 in 1997 and 2,642 in 1996. In 1999, the Company expects to add about 1,750 restaurants, with a continued emphasis on traditional restaurants primarily in locations outside the U.S.

	1998	1997	1996	1995	1994
U.S.	**12,472**	12,380	12,094	11,368	10,238
Europe	**4,421**	3,886	3,283	2,595	2,159
Asia/Pacific	**5,055**	4,456	3,633	2,735	2,168
Latin America	**1,405**	1,091	837	665	505
Other	**1,447**	1,319	1,175	1,017	880
Systemwide restaurants	**24,800**	23,132	21,022	18,380	15,950

The U.S. net additions declined in 1998 and 1997, primarily due to the closing of low-volume satellite locations and a more stringent restaurant selection process.

Asia/Pacific's percent of total restaurants has grown primarily due to Japan's significant expansion. Japan added 415 restaurants in 1998, 433 in 1997 and 522 in 1996, representing 25% of Systemwide restaurant additions in 1998 and about 20% in 1997 and 1996. Approximately 60% of Japan's restaurant additions in 1998 and 1997, and about 70% in 1996, were satellites. Therefore, these additions affected unit growth more than sales growth.

At the end of 1998, 84% of Systemwide restaurants were in the major markets, compared with 85% in 1997. In 1998, 65% of restaurant additions were in these major markets, and we anticipate a similar percent for 1999. Longer term, markets like China, Italy and Mexico are expected to represent a growing proportion of restaurant additions.

More than 75% of Company-operated restaurants and more than 85% of franchised restaurants were located in the major markets in 1998. Franchisees and affiliates operated 78% of restaurants at year-end 1998. That percentage has remained relatively constant over the past three years.

Financial position and capital resources

Total assets and capital expenditures

Total assets grew $1.5 billion or 8% in 1998 and $856 million or 5% in 1997. In 1998 and 1997, about 80% of consolidated assets were located in our major markets excluding our affiliate in Japan. Net property and equipment rose $1.1 billion in 1998 and represented 81% of total assets at year end.

Capital expenditures decreased $232 million or 11% in 1998 and decreased $264 million or 11% in 1997, reflecting fewer restaurant additions, the new building program in the U.S. in 1998 that gave owner/operators the option to own new restaurant facilities, and more leased sites, combined with weaker foreign currencies.

U.S. capital expenditures declined $139 million or 24% in 1998 and declined $300 million or 34% in 1997, primarily due to a more selective expansion strategy and the new building program. About 70% of the qualifying new traditional restaurant buildings opened in 1998 are owned by owner/operators. In addition, the Company leased the land for over 90% of the new traditional restaurants opened in the U.S. in 1998. These programs saved the Company approximately $155 million in capital outlays in 1998.

Capital expenditures outside the U.S. decreased $93 million or 6%, due to fewer restaurant additions and weaker foreign currencies in 1998. Capital expenditures outside the U.S. increased slightly in 1997.

In 1998, 76% of capital expenditures was invested in markets outside the U.S., compared with 72% in 1997 and 63% in 1996. Approximately 70% was invested in our major markets excluding Japan in 1998, compared with 73% in 1997 and 78% in 1996.

(In millions)	**1998**	1997	1996	1995	1994
New restaurants	**$ 1,357**	$ 1,531	$ 1,799	$ 1,550	$ 1,181
Existing restaurants	**398**	433	350	355	211
Other properties	**124**	147	226	159	147
Capital expenditures	**$ 1,879**	$ 2,111	$ 2,375	$ 2,064	$ 1,539
Total assets	**$19,784**	$18,242	$17,386	$15,415	$13,592

Expenditures for existing restaurants were made to achieve higher levels of customer satisfaction, including technology to improve service and food quality, and to enhance older facilities. Other properties primarily included expenditures for office buildings and related computer equipment and furnishings.

The Company's expenditures for new restaurants in the U.S. were minimal as a result of the programs previously discussed. However, we continue to focus on the System's average development costs (land, building and equipment) to ensure an appropriate return on investment for the System. Average development costs for the U.S. System were $1.4 million in 1998 and $1.3 million in 1997. The increase was primarily due to the construction of larger facilities to support higher average sales volumes.

Average development costs for traditional restaurants in our major markets outside the U.S., excluding Japan, were approximately $1.8 million in both 1998 and 1997. Average development costs vary widely by market depending on the types of restaurants built and the real estate and construction costs within each market. These costs are managed through the use of right-sized restaurants, construction and design efficiencies, standardization and global sourcing. Average development costs for satellite restaurants located in Brazil, Canada and Japan, which comprise over 90% of all satellites outside the U.S., were approximately $200,000 in both years. The utilization of these small, often limited-menu restaurants has allowed expansion into areas that would otherwise not have been feasible.

Including affiliates, total land ownership was 44% and 45% of total restaurant sites at year-end 1998 and 1997, respectively.

Capital expenditures by affiliates, which were not included in consolidated amounts, were approximately $295 million in 1998, compared with $360 million in 1997. The decrease was primarily due to increased ownership in the Philippines, South Korea and Thailand, which converted them from affiliates to majority-owned subsidiaries in 1998, and to a lesser extent, weaker foreign currencies.

Cash provided by operations

The Company generates significant cash from operations and has substantial borrowing capacity to meet its operating and discretionary spending requirements. Free cash flow (cash from operations less capital expenditures) grew to $887 million in 1998, compared with $331 million in 1997. Cash provided by operations was reduced by approximately $135 million of Made For You incentive payments made in 1998 and $110 million of U.S. franchisee security deposit refunds in 1997. Cash provided by operations, along with other sources of cash such as borrowings, was used for capital expenditures, share repurchase, dividends and debt repayments. The Company generated positive free cash flow in 1998 for the eighth consecutive year. This trend is expected to continue. In 1998, operations outside the U.S. generated positive free cash flow for the first time in our history, and this is expected to continue into the foreseeable future.

(Dollars in millions)	**1998**	1997	1996	1995	1994
Cash provided by operations	**$2,766**	$2,442	$2,461	$2,296	$1,926
Free cash flow	**887**	331	86	232	387
Cash provided by operations as a percent of capital expenditures	**147%**	116%	104%	111%	125%
Cash provided by operations as a percent of average total debt	**41**	41	48	49	48

In addition to its free cash flow, the Company can meet short-term needs through commercial paper borrowings and line of credit agreements. Accordingly, the Company strategically maintains a relatively low current ratio—.52 at year-end 1998.

Financings and market risk

The Company is exposed to the impact of interest-rate changes and foreign currency fluctuations. McDonald's strives to minimize these risks by financing with debt in the currencies in which assets are denominated and employing established policies and procedures to manage this exposure. See Summary of significant accounting policies on page 37 for additional information regarding our use of financial instruments and the impact of the new accounting standard on derivatives.

The Company uses major capital markets and various techniques to meet its financing requirements and reduce interest expense. For example, currency exchange agreements in conjunction with borrowings help obtain desired currencies at attractive rates and maturities. Interest-rate exchange agreements effectively convert fixed-rate to floating-rate debt, or vice versa. The Company also manages the level of fixed-rate debt to take advantage of changes in interest rates.

The Company uses foreign currency debt and derivatives to hedge intercompany financings and long-term investments in foreign subsidiaries and affiliates. This reduces the impact of fluctuating foreign currencies on net income and shareholders' equity. Total foreign-denominated debt, including the effects of currency exchange agreements, was $5.2 billion and $5.0 billion at year-end 1998 and 1997, respectively.

(As a percent)	**1998**	1997	1996	1995	1994
Fixed-rate debt as a percent of total debt	**67%**	49%	68%	67%	64%
Weighted-average annual interest rate of total debt	**6.6**	6.8	7.1	7.9	8.4
Foreign currency-denominated debt as a percent of total debt	**75**	80	90	89	92
Total debt as a percent of total capitalization (total debt and total shareholders' equity)	**43**	42	39	38	39

Moody's and Standard & Poor's have rated McDonald's debt Aa2 and AA, respectively, since 1982. Duff & Phelps began rating the debt in 1990 and currently rates it AA+. These strong ratings are important to the Company because of global development plans. The Company has not experienced, nor does it expect to experience, difficulty in obtaining financing or refinancing existing debt. At year-end 1998, the Company and its subsidiaries had $1.5 billion available under committed line of credit agreements, $1.0 billion under a Euro medium-term note program and $.9 billion under shelf registrations for future debt issuance.

The Company manages its debt portfolio in response to changes in interest rates and foreign currency rates by periodically retiring, redeeming and repurchasing debt; terminating exchange agreements; and using derivatives. Gains of approximately $24 million, related to the early termination of interest-rate exchange agreements in 1998, were deferred and are being amortized as an adjustment to interest expense over various periods through 2002. The Company does not use derivatives with a level of complexity or with a risk higher than the exposures to be hedged and does not hold or issue derivatives for trading purposes. All exchange agreements are over-the-counter instruments.

The Company actively hedges selected currencies to minimize the effect of fluctuating foreign currencies on reported results and to minimize the cash exposure of foreign currency royalty and other payments received in the U.S. In addition, where practical, McDonald's restaurants purchase goods and services in local currencies resulting in natural hedges, and the Company typically finances in local currencies, creating economic hedges.

The Company's exposure is diversified among a broad basket of currencies. At year-end 1998 and 1997, assets in hyperinflationary markets were principally financed in U.S. Dollars. The Company's largest net asset exposures (defined as foreign currency assets less foreign currency liabilities) were as follows:

(In millions of U.S. Dollars)	December 31, **1998**	1997
Canadian Dollars	**$749**	$528
Deutsche Marks	**456**	88
British Pounds Sterling	**447**	590
Australian Dollars	**322**	298
Brazilian Reais	**302**	281
French Francs	**196**	194
Austrian Schillings	**116**	91
Japanese Yen	**116**	37

The Company prepared sensitivity analyses of its financial instruments to determine the impact of hypothetical changes in interest rates and foreign currency exchange rates on the Company's results of operations, cash flows and the fair value of its financial instruments. The interest-rate analysis assumed a one percentage point adverse change in interest rates on all financial instruments but did not consider the effects of the reduced level of economic activity that could exist in such an environment. The foreign currency rate analysis assumed that each foreign currency rate would change by 10% in the same direction relative to the U.S. Dollar on all financial instruments; however, the analysis did not include the potential impact on sales levels or local currency prices or the effect of fluctuating currencies on the Company's anticipated foreign currency royalties and other payments received in the U.S. Based on the results of these analyses of the Company's financial instruments, neither a one percentage point adverse change in interest rates from year-end 1998 levels nor a 10% adverse change in foreign currency rates from year-end 1998 levels would materially affect the Company's results of operations, cash flows or the fair value of its financial instruments.

Total shareholders' equity

Total shareholders' equity rose $613 million or 7% in 1998, and represented 48% of total assets at year end. Weaker foreign currencies decreased shareholders' equity by $52 million in 1998.

The Company uses free cash flow and debt capacity to repurchase shares because we believe this enhances shareholder value. Over the past 10 years, the Company has invested $4.8 billion to buy back 306 million shares at an average price of approximately $16, while maintaining a strong equity base. At year-end 1998, the Company held 304 million shares in treasury with a market value of $11.7 billion.

In September 1998, the Company announced plans to repurchase $3.5 billion of its common stock by year-end 2001. During the third quarter 1998, the Company completed its $2 billion, three-year share repurchase program begun in 1996. In 1998, the Company repurchased a total of 38 million shares for nearly $1.2 billion, $320 million of which related to the new $3.5 billion program. The Company uses common equity put options in connection with its share repurchase program. In 1998, the Company sold 7.3 million common equity put options, of which 1.0 million options were outstanding at December 31, 1998. These options expired unexercised in February 1999.

Given the Company's returns on equity and assets, management believes it is prudent to reinvest a significant portion of earnings back into the business and use free cash flow for share repurchase. Accordingly, the common stock dividend yield is modest. However, the Company has paid 92 consecutive quarterly dividends on common stock through first quarter 1999 and has increased the dividend amount at least once every year. Additional dividend increases will be considered after reviewing returns to shareholders, profitability expectations and financing needs.

Returns

Operating income is used to compute return on average assets, while net income less preferred stock dividends (net of tax) is used to calculate return on average common equity. Month-end balances are used to compute both average assets and average common equity.

(As a percent)	**1998**	1997	1996	1995	1994
Return on average assets[1]	**16.4%**	16.0%	16.8%	17.9%	17.6%
Return on average common equity[1]	**19.5**	19.0	19.5	19.9	19.4

(1) Computed excluding Made For You costs and special charges. Including Made For You costs and special charges, return on average assets was 14.7% in 1998 and 16.3% in 1996; return on average common equity was 17.1% in 1998.

The increases in the 1998 returns are due to strong operating results, enhanced by the Company's continued focus on more efficient capital deployment. This included the closing of a number of low-volume satellite restaurants, a more stringent site selection process, the new building program in the U.S. and the use of free cash flow for share repurchase.

Other matters

Effects of changing prices—inflation

The Company has demonstrated an ability to manage inflationary cost increases effectively. This is because of rapid inventory turnover, the ability to adjust prices, cost controls and substantial property holdings—many of which are at fixed costs and partly financed by debt made cheaper by inflation. In hyperinflationary markets, menu board prices are typi-

cally adjusted to keep pace with inflation, mitigating the effect on reported results.

Year 2000

The Company has assessed its computerized systems to determine their ability to correctly identify the Year 2000 and is devoting the necessary internal and external resources to replace, upgrade or modify all significant systems which do not correctly identify the Year 2000. Substantially all necessary modifications and testing of the Company's significant systems have been completed. The last necessary replacement of a significant system is expected to be completed in third quarter 1999.

In addition, the Company has determined the extent to which its operations may be affected by the compliance efforts of its significant suppliers and is taking the necessary steps to minimize potential problems. The Company has implemented a Systemwide supply chain compliance monitoring program, which encompasses supplier risk assessment and compliance validation for significant suppliers.

Management does not expect Year 2000 issues relating to internal systems and suppliers to pose significant operational or financial difficulties for the Company; however, in the unlikely event McDonald's or a significant number of its key suppliers are unable to resolve an issue in a timely manner, such matters could have a material impact on the Company's results of operations. In addition, failures related to Year 2000 issues by providers of infrastructure services could have a material adverse effect on results of operations. Contingency plans are being developed, to the extent feasible, to address unexpected Year 2000 issues that might arise either internally, within the supply chain or by infrastructure service providers. These plans are expected to be completed well before the end of 1999.

Modification and testing costs are expensed as incurred, while the costs of new systems are capitalized. The Company expects its total costs related to modification and testing as well as costs associated with supply chain risk assessment and contingency planning to be less than $35 million, of which approximately $23 million was incurred through December 31, 1998. In addition, the Company expects to capitalize approximately $55 million of costs for ongoing development of significant new systems that are replacing non-Year 2000 compliant systems. About $40 million of these costs were capitalized at December 31, 1998. The total Year 2000 costs have not and are not expected to have a material adverse impact on the Company's financial position, results of operations or cash flows.

All Year 2000 statements contained herein are designated as "Year 2000 Readiness Disclosures" pursuant to the Year 2000 Information and Readiness Disclosure Act of 1998.

Euro conversion

On January 1, 1999, 11 member countries of the European Union established fixed conversion rates between their existing currencies ("legacy currencies") and one common currency, the Euro. The Euro is now trading on currency exchanges and may be used in certain transactions such as electronic payments. Beginning in January 2002, new Euro-denominated notes and coins will be issued, and legacy currencies will be withdrawn from circulation. The conversion to the Euro has eliminated currency exchange rate risk for transactions between the member countries, which for the Company, primarily consist of payments to suppliers. In addition, as the Company uses foreign-denominated debt and derivatives to meet its financing requirements and to minimize its foreign currency risks, certain of these financial instruments will be redenominated into Euros.

The Company has restaurants located in all member countries and has been preparing for the introduction of the Euro for the past several years. The Company is currently addressing the issues involved with the new currency, which include converting information technology systems, recalculating currency risk, recalibrating derivatives and other financial instruments and revising processes for preparing accounting and taxation records. Based on the work to date, the Company does not believe the Euro conversion will have a significant impact on the Company's financial position, results of operations or cash flows.

Forward-looking statements

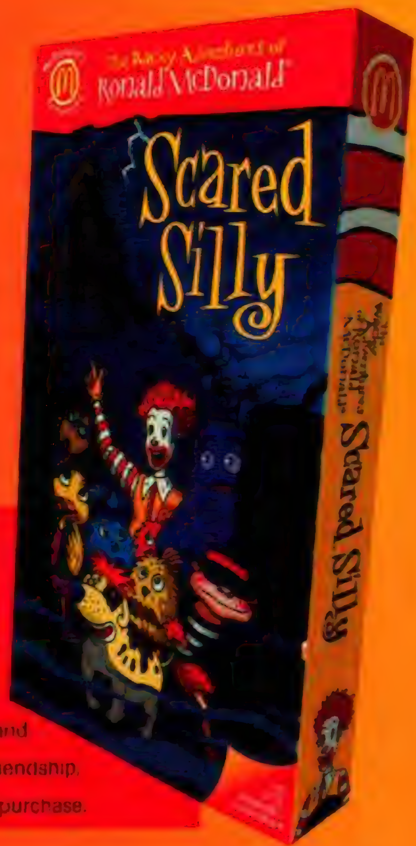
Certain forward-looking statements are included in this report. They use such words as "may," "will," "expect," "believe," "plan" and other similar terminology. These statements reflect management's current expectations and involve a number of risks and uncertainties. Actual results could differ materially due to the success of operating initiatives, advertising and promotional efforts, Year 2000 compliance efforts and Euro conversion efforts, as well as changes in: global and local business and economic conditions; currency exchange and interest rates; food, labor and other operating costs; political or economic instability in local markets; competition; consumer preferences, spending patterns and demographic trends; availability and cost of land and construction; legislation and governmental regulation; and accounting policies and practices.

News

McFlurry in the forecast

You won't need snow shoes and a shovel for this McFlurry. A long spoon will do just fine for enjoying these frozen dairy treats. First introduced in Canada, McFlurry desserts mix McDonald's soft-serve, reduced-fat ice cream with candy or cookie pieces like M&Ms, Butterfingers or Oreos. Available in selected restaurants in Canada, the U.S. and 34 other countries, the delicious McFlurry desserts have worldwide appeal.

Offering great snacks is key to attracting more customers throughout the day, helping to build sales and profits. High customer acceptance and low equipment cost mean a quick payback on investment. Our McFlurry, cones, sundaes and other great desserts give customers more delicious reasons to stop by McDonald's more often. McFlurry desserts—the coolest way to cool off at McDonald's.



International birthdays

It's amazing how quickly the birthday candles add up. Last year, ten countries celebrated key anniversaries. Sweden celebrated its 25th anniversary, and Belgium and Norway observed their 20th and 15th anniversaries, respectively. Yugoslavia, South Korea and Hungary commemorated their 10th anniversaries and Iceland, Israel, Slovenia and Saudi Arabia observed their 5th year in the McDonald's family. Other milestones in 1998 included welcoming Moldova, Nicaragua, Lebanon, Pakistan and Sri Lanka to the McDonald's family and the opening of the 100th McDonald's restaurant in Poland, Puerto Rico, Switzerland and Turkey.

Ronald McDonald video series

Kids and their parents in the U.S. enthusiastically welcomed the new Ronald McDonald video series. Building on Ronald's special relationship with children, this animated video adventure series was successfully launched in October 1998 with "Scared Silly," and continued with "The Legend of Grimace Island" in January 1999. "The Visitors from Outer Space" will follow in spring 1999.

This video series provides kids of all ages a fresh, new way to relate to Ronald and his McDonaldland friends. Through animation and live action, each video portrays a positive message about either friendship, bravery or honesty. The videos are a great value at a recommended price of $3.49 with any menu purchase.

Brighten your morning

Imagine a bagel: fresh, soft, satisfying. Now imagine a bagel sandwich made by McDonald's: hearty, flavorful, fresh-baked each morning. If you live near one of the many restaurants in the U.S. testing our new breakfast bagel sandwiches, you don't have to imagine for long. Created to give customers tasty new choices for breakfast, our bagel sandwiches are offered in the flavorful combinations of steak, egg and cheese; ham, egg and cheese; and Spanish omelet with sausage and cheese. Bagels as only McDonald's can make them...just another reason to brighten your mornings at the Golden Arches.

and Notes

World Cup '98 scores Reaping the benefits of "the most effective sponsorship money can buy" according to *USA Today*, McDonald's leveraged the world's most widely watched sporting event to build our brand. To generate excitement among customers, McDonald's restaurants in more than 90 countries promoted our World Cup involvement through specially themed packaging, World Cup-themed Happy Meal premiums and special Extra Value Meal promotions. McDonald's sponsorship of the World Cup makes a leadership statement about the global strength of our brand and enables us to more closely connect with customers around the world.

Opportunity on the menu The White House recognized McDonald's for fostering women- and minority-owned business development. We were lauded for our expertise in franchising and training, commitment to community outreach and successful supplier development programs. Also, the *Minority Business Report*, a nationally broadcast television show, honored McDonald's and the National Black McDonald's Operators Association as its 1998 Corporation of the Year and Advocate of the Year, respectively. This is the first time one company simultaneously received both top honors.

Opportunity is always on McDonald's menu. One-third of our U.S. owner/operators and about two-thirds of owner/operators in training are women and minorities. We also extend opportunity to women- and minority-owned suppliers, from whom we purchased almost $3 billion of goods and services in 1998.

McScholars McDonald's believes in the value of education and, with our owner/operators and Ronald McDonald House Charities, proudly provides millions of dollars in educational assistance. Some of the programs we support are the McDonald's National Employee Scholarship Program, the Hispanic-American Commitment to Education and the United Negro College Fund/Medical Scholars programs. McDonald's National Employee Scholarship Program recognizes our restaurant employees' success in balancing school and work. Each year, this program grants educational scholarships of $1,000 to 52 employees throughout the U.S. The individual exemplifying the highest commitment to school, work and volunteer activities is named McDonald's McScholar of the Year and receives a $5,000 scholarship. In 1998, we proudly recognized Amelia Borrego, a student at Georgetown University in Washington, D.C., with this award.

Snoopy world tour International pop-culture idol, Snoopy, had customers in Hong Kong flocking to McDonald's for the chance to get a Snoopy World Tour toy with the purchase of an Extra Value Meal. This phenomenally successful promotion featured a series of Snoopy dolls dressed in different cultural costumes, with a new Snoopy available each day during the 28-day promotion.

Also, we congratulate our Hong Kong team for winning the prestigious Hong Kong Management Association's 1998 Quality Award. This honor recognized McDonald's Hong Kong's excellence in seven areas: leadership, strategic planning, customer and market focus, information and analysis, human resource development and management, process management and business results.

Consolidated Statement of Income

(In millions, except per share data) *Years ended December 31,*	**1998**	1997	1996
Revenues			
Sales by Company-operated restaurants	**$ 8,894.9**	$ 8,136.5	$ 7,570.7
Revenues from franchised and affiliated restaurants	**3,526.5**	3,272.3	3,115.8
Total revenues	**12,421.4**	11,408.8	10,686.5
Operating costs and expenses			
Company-operated restaurants			
Food and packaging	**2,997.4**	2,772.6	2,546.6
Payroll and employee benefits	**2,220.3**	2,025.1	1,909.8
Occupancy and other operating expenses	**2,043.9**	1,851.9	1,706.8
	7,261.6	6,649.6	6,163.2
Franchised restaurants—occupancy expenses	**678.0**	613.9	570.1
Selling, general and administrative expenses	**1,458.5**	1,450.5	1,366.4
Made For You costs	**161.6**		
Special charges	**160.0**		72.0
Other operating (income) expense	**(60.2)**	(113.5)	(117.8)
Total operating costs and expenses	**9,659.5**	8,600.5	8,053.9
Operating income	**2,761.9**	2,808.3	2,632.6
Interest expense—net of capitalized interest of $17.9, $22.7 and $22.2	**413.8**	364.4	342.5
Nonoperating (income) expense	**40.7**	36.6	39.1
Income before provision for income taxes	**2,307.4**	2,407.3	2,251.0
Provision for income taxes	**757.3**	764.8	678.4
Net income	**$ 1,550.1**	$ 1,642.5	$ 1,572.6
Net income per common share	**$ 1.14**	$ 1.17	$ 1.11
Net income per common share—diluted	**1.10**	1.15	1.08
Dividends per common share	**$ .18**	$ .16	$ .15
Weighted-average shares	**1,365.3**	1,378.7	1,396.4
Weighted-average shares—diluted	**1,405.7**	1,410.2	1,433.3

The accompanying Financial Comments are an integral part of the consolidated financial statements.

Consolidated Balance Sheet

(In millions, except per share data)	*December 31,* **1998**	1997
Assets		
Current assets		
Cash and equivalents	**$ 299.2**	$ 341.4
Accounts and notes receivable	**609.4**	483.5
Inventories, at cost, not in excess of market	**77.3**	70.5
Prepaid expenses and other current assets	**323.5**	246.9
Total current assets	**1,309.4**	1,142.3
Other assets		
Notes receivable due after one year	**67.9**	67.0
Investments in and advances to affiliates	**854.1**	634.8
Intangible assets—net	**973.1**	827.5
Miscellaneous	**538.3**	608.5
Total other assets	**2,433.4**	2,137.8
Property and equipment		
Property and equipment, at cost	**21,758.0**	20,088.2
Accumulated depreciation and amortization	**(5,716.4)**	(5,126.8)
Net property and equipment	**16,041.6**	14,961.4
Total assets	**$19,784.4**	$18,241.5
Liabilities and shareholders' equity		
Current liabilities		
Notes payable	**$ 686.8**	$ 1,293.8
Accounts payable	**621.3**	650.6
Income taxes	**94.2**	52.5
Other taxes	**143.5**	148.5
Accrued interest	**132.3**	107.1
Other accrued liabilities	**651.0**	396.4
Current maturities of long-term debt	**168.0**	335.6
Total current liabilities	**2,497.1**	2,984.5
Long-term debt	**6,188.6**	4,834.1
Other long-term liabilities and minority interests	**492.6**	427.5
Deferred income taxes	**1,081.9**	1,063.5
Common equity put options	**59.5**	80.3
Shareholders' equity		
Preferred stock, no par value; authorized—165.0 million shares; issued—none		
Common stock, $.01 par value; authorized—3.5 billion shares; issued—1,660.6 million	**16.6**	16.6
Additional paid-in capital	**989.2**	690.9
Guarantee of ESOP Notes	**(148.7)**	(171.3)
Retained earnings	**13,879.6**	12,569.0
Accumulated other comprehensive income	**(522.5)**	(470.5)
Common stock in treasury, at cost; 304.4 and 289.2 million shares	**(4,749.5)**	(3,783.1)
Total shareholders' equity	**9,464.7**	8,851.6
Total liabilities and shareholders' equity	**$19,784.4**	$18,241.5

The accompanying Financial Comments are an integral part of the consolidated financial statements.

Consolidated Statement of Cash Flows

(In millions)	*Years ended December 31,* **1998**	1997	1996
Operating activities			
Net income	**$ 1,550.1**	$ 1,642.5	$ 1,572.6
Adjustments to reconcile to cash provided by operations			
Depreciation and amortization	**881.1**	793.8	742.9
Deferred income taxes	**35.4**	(1.1)	32.9
Changes in operating working capital items			
Accounts receivable	**(29.9)**	(57.6)	(77.5)
Inventories, prepaid expenses and other current assets	**(18.1)**	(34.5)	(18.7)
Accounts payable	**(12.7)**	52.8	44.5
Taxes and other liabilities	**337.5**	221.9	121.4
Refund of U.S. franchisee security deposits		(109.6)	
Other	**22.9**	(65.9)	42.9
Cash provided by operations	**2,766.3**	2,442.3	2,461.0
Investing activities			
Property and equipment expenditures	**(1,879.3)**	(2,111.2)	(2,375.3)
Purchases of restaurant businesses	**(118.4)**	(113.6)	(137.7)
Sales of restaurant businesses	**149.0**	149.5	198.8
Property sales	**42.5**	26.9	35.5
Other	**(142.0)**	(168.8)	(291.6)
Cash used for investing activities	**(1,948.2)**	(2,217.2)	(2,570.3)
Financing activities			
Net short-term borrowings (repayments)	**(604.2)**	1,097.4	228.8
Long-term financing issuances	**1,461.5**	1,037.9	1,391.8
Long-term financing repayments	**(594.9)**	(1,133.8)	(841.3)
Treasury stock purchases	**(1,089.8)**	(755.1)	(599.9)
Common and preferred stock dividends	**(240.5)**	(247.7)	(232.0)
Series E preferred stock redemption		(358.0)	
Other	**207.6**	145.7	157.0
Cash provided by (used for) financing activities	**(860.3)**	(213.6)	104.4
Cash and equivalents increase (decrease)	**(42.2)**	11.5	(4.9)
Cash and equivalents at beginning of year	**341.4**	329.9	334.8
Cash and equivalents at end of year	**$ 299.2**	$ 341.4	$ 329.9
Supplemental cash flow disclosures			
Interest paid	**$ 406.5**	$ 401.7	$ 369.0
Income taxes paid	**$ 545.9**	$ 650.8	$ 558.1

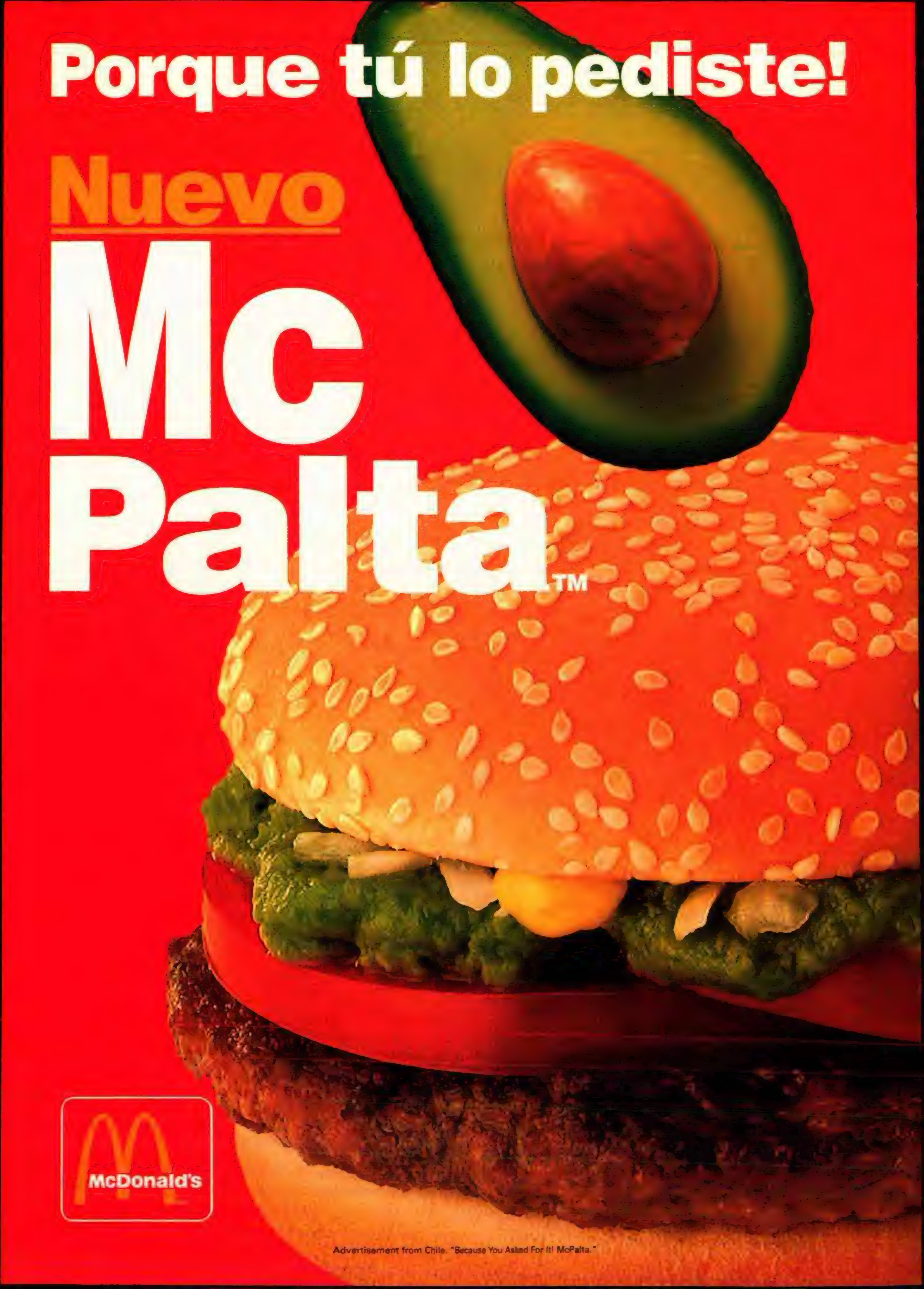
The accompanying Financial Comments are an integral part of the consolidated financial statements.

Consolidated Statement of Shareholders' Equity

(In millions, except per share data)	Preferred stock issued*	Common stock issued: Shares	Common stock issued: Amount	Additional paid-in capital	Guarantee of ESOP Notes	Retained earnings	Accumulated other comprehensive income	Common stock in treasury: Shares	Common stock in treasury: Amount	Total shareholders' equity
Balance at December 31, 1995	$358.0	1,660.6	$184.6	$295.1	$(214.2)	$ 9,831.3	$ (87.1)	(261.2)	$(2,506.4)	$7,861.3
Net income						1,572.6				1,572.6
Translation adjustments (including taxes of $50.6)							(88.0)			(88.0)
Comprehensive income										1,484.6
Common stock cash dividends ($.15 per share)						(203.3)				(203.3)
Preferred stock cash dividends ($1.93 per Series E depositary share)						(27.6)				(27.6)
Conversion to $.01 par value stock			(168.0)	168.0						
ESOP Notes payment					20.2					20.2
Treasury stock acquisitions								(25.8)	(604.8)	(604.8)
Stock option exercises and other (including tax benefits of $86.4)				102.8	0.8			15.6	84.2	187.8
Balance at December 31, 1996	358.0	1,660.6	16.6	565.9	(193.2)	11,173.0	(175.1)	(271.4)	(3,027.0)	8,718.2
Net income						1,642.5				1,642.5
Translation adjustments (including taxes of $104.0)							(295.4)			(295.4)
Comprehensive income										1,347.1
Common stock cash dividends ($.16 per share)						(221.2)				(221.2)
Preferred stock cash dividends ($1.93 per Series E depositary share)						(25.3)				(25.3)
ESOP Notes payment					21.4					21.4
Treasury stock acquisitions								(32.4)	(765.0)	(765.0)
Common equity put options issuance									(80.3)	(80.3)
Preferred stock redemption	(358.0)									(358.0)
Stock option exercises and other (including tax benefits of $79.2)				125.0	0.5			14.6	89.2	214.7
Balance at December 31, 1997	0.0	1,660.6	16.6	690.9	(171.3)	12,569.0	(470.5)	(289.2)	(3,783.1)	8,851.6
Net income						**1,550.1**				**1,550.1**
Translation adjustments (including tax benefits of $84.2)							**(52.0)**			**(52.0)**
Comprehensive income										**1,498.1**
Common stock cash dividends ($.18 per share)						**(239.5)**				**(239.5)**
ESOP Notes payment					**22.5**					**22.5**
Treasury stock acquisitions								**(38.0)**	**(1,161.9)**	**(1,161.9)**
Common equity put options issuance and expiration, net									**20.8**	**20.8**
Stock option exercises and other (including tax benefits of $154.0)				**298.3**	**0.1**			**22.8**	**174.7**	**473.1**
Balance at December 31, 1998	**$ 0.0**	**1,660.6**	**$ 16.6**	**$989.2**	**$(148.7)**	**$13,879.6**	**$(522.5)**	**(304.4)**	**$(4,749.5)**	**$9,464.7**

**At December 31, 1996 and 1995, 7.2 thousand shares were outstanding. These shares were redeemed in 1997.*

The accompanying Financial Comments are an integral part of the consolidated financial statements.



Advertisement from Chile. "Because You Asked For It! McPalta."

Financial Comments

Summary of significant accounting policies

Consolidation
The consolidated financial statements include the accounts of the Company and its subsidiaries. Investments in affiliates owned 50% or less are accounted for by the equity method.

Estimates in financial statements
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Foreign currency translation
The functional currency of substantially all operations outside the U.S. is the respective local currency, except for hyperinflationary countries where it is the U.S. Dollar.

Advertising costs
Production costs for radio and television advertising are expensed when the commercials are initially aired. Advertising expenses included in costs of Company-operated restaurants and in selling, general and administrative expenses were (in millions): 1998–$486.3; 1997–$548.7; 1996–$503.3.

Stock-based compensation
The Company accounts for stock options as prescribed by APB Opinion No. 25 and includes pro forma information in the Stock options footnote, as provided by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation.*

Property and equipment
Property and equipment are stated at cost, with depreciation and amortization provided using the straight-line method over the following estimated useful lives: buildings–up to 40 years; leasehold improvements–lesser of useful lives of assets or lease terms including option periods; and equipment–three to 12 years.

Intangible assets
Intangible assets, primarily franchise rights reacquired from franchisees and affiliates, are amortized using the straight-line method over an average life of about 30 years.

Financial instruments
The Company uses derivatives to manage risk, not for trading purposes. Non-U.S. Dollar financing transactions generally are effective as hedges of either long-term investments in or intercompany loans to foreign subsidiaries and affiliates. Foreign currency translation adjustments from gains and losses on hedges of long-term investments are recorded in shareholders' equity as other comprehensive income. Gains and losses related to hedges of intercompany loans offset the gains and losses on intercompany loans and are recorded in nonoperating (income) expense.

Interest-rate exchange agreements are designated and effective to modify the Company's interest-rate exposures. Net interest is accrued as either interest receivable or payable with the offset recorded in interest expense. Gains or losses from the early termination of interest-rate exchange agreements are amortized as an adjustment to interest expense over the shorter of the remaining life of the interest-rate agreement or the underlying debt being hedged.

The Company purchases foreign currency options (with little or no initial intrinsic value) that are effective as hedges of anticipated foreign currency royalty and other payments received in the U.S. The premiums paid for these options are amortized over the option life and are recorded as nonoperating expense. Any realized gains on exercised options are deferred and recognized in the period in which the related royalty or other payment is received.

Forward foreign exchange contracts are also used to mitigate exposure on foreign currency royalty and other payments received from affiliates and subsidiaries. These contracts are marked to market with the resulting gains or losses recorded in nonoperating (income) expense. In addition, forward foreign exchange contracts are used to hedge long-term investments in foreign subsidiaries and affiliates. These contracts are marked to market with the resulting gains or losses recorded in shareholders' equity as other comprehensive income.

If a hedged item matures or is extinguished, or if a hedged anticipated royalty or other payment is no longer probable, the associated derivative is marked to market with the resulting gain or loss recognized immediately. The derivative is then redesignated as a hedge of another item or terminated.

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which is required to be adopted in years beginning after June 15, 1999. The Statement will require the Company to recognize all derivatives on the balance sheet at fair value. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged item through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The Company expects to adopt the new Statement effective January 1, 2000. Management does not anticipate that the adoption will have a material effect on the Company's results of operations or financial position.

Per common share information
Income used in the computation of per common share information was reduced by preferred stock cash dividends (net of applicable tax benefits) of $25.3 million in 1997 and $27.6 million in 1996. The Company retired its remaining Series E Preferred Stock in December 1997. Diluted net income per common share includes the dilutive effect of stock options.

On January 26, 1999, the Board of Directors declared a two-for-one stock split of the Company's common stock, effected in the form of a stock dividend paid on March 5, 1999. As a result of this action, 830.3 million shares were issued to share-

holders of record as of February 12, 1999. Par value of the stock remains at $.01 per share and accordingly, $8.3 million were transferred from additional paid-in capital to common stock. All references to the number of common shares and per common share amounts have been restated to give retroactive effect to the stock split for all periods presented.

Statement of cash flows
The Company considers short-term, highly liquid investments to be cash equivalents. The impact of fluctuating foreign currencies on cash and equivalents was not material.

Other operating (income) expense

(In millions)	1998	1997	1996
Gains on sales of restaurant businesses	**$ (60.7)**	$ (59.0)	$ (85.2)
Equity in earnings of unconsolidated affiliates	**(88.7)**	(72.8)	(76.8)
Net losses from property dispositions	**71.1**	29.1	41.1
Other	**18.1**	(10.8)	3.1
Other operating (income) expense	**$ (60.2)**	$(113.5)	$(117.8)
Made For You costs	**$161.6**		
Special charges	**$160.0**		$ 72.0

Other operating (income) expense
Net losses from property dispositions in 1996 included $16.0 million for certain restaurant sites in Mexico, upon the adoption of SFAS No. 121, and in 1998 reflected an increased number of restaurant closings.

Made For You costs
In 1998, the Company announced the introduction of Made For You, a new food preparation system that is expected to be installed in virtually all restaurants in the U.S. and Canada by the end of 1999. As part of the plan to introduce this system, the Company is providing financial incentives of up to $12,500 per restaurant to owner/operators to defray the cost of equipment made obsolete as a result of converting to the new system. The Company also is making additional payments in special cases where the conversion to Made For You is more extensive.

In 1998, the Company incurred $161.6 million in Made For You costs, which primarily consisted of nonrefundable incentive payments made to owner/operators as well as accelerated depreciation on equipment being replaced in Company-operated restaurants.

Special charges
In second quarter 1998, the Company recorded a $160.0 million pre-tax special charge related to the Company's home office productivity initiative. This initiative is designed to improve staff alignment, focus and productivity and reduce ongoing selling, general and administrative expenses. As a result, the Company is reducing home office staffing by approximately 525 positions, consolidating certain home office facilities and reducing other expenditures in a variety of areas. The special charge was comprised of $85.8 million of employee severance and outplacement costs, $40.8 million of lease cancellation and other facilities-related costs, $18.3 million of costs for the write-off of capitalized technology made obsolete as a result of the productivity initiative, and $15.1 million of other cash payments made in 1998. Employee severance is paid in semi-monthly installments over a period of up to one year after termination.

As of December 31, 1998, the Company had reduced home office staffing by approximately 400 positions and expects the remaining positions to be eliminated by year-end 1999. The remaining accrual, primarily related to employee severance, was approximately $105 million at December 31, 1998 and is included in Other accrued liabilities in the Consolidated Balance Sheet. No significant adjustments have been made to the original plan approved by management in second quarter 1998.

In 1996, the Company recorded a $72.0 million pre-tax special charge related primarily to plans to strengthen the U.S. business and reduce ongoing costs by closing certain low-volume U.S. satellite restaurants, outsourcing excess property management and implementing other cost efficiencies. The actions required by this plan were completed in 1997 and resulted in no significant adjustments to the original cost estimate.

Franchise arrangements

Franchise arrangements generally include a lease and a license and provide for payment of initial fees, as well as continuing rent, service fees and royalties to the Company, based upon a percentage of sales with minimum rent payments. Franchisees are granted the right to operate a McDonald's restaurant using the McDonald's system as well as the use of a restaurant facility, generally for a period of 20 years. Franchisees pay related occupancy costs including property taxes, insurance and maintenance. Beginning in 1998, franchisees in the U.S. generally have the option to own new restaurant facilities while leasing the land from McDonald's. In addition, franchisees outside the U.S. pay a refundable, noninterest-bearing security deposit. The results of operations of restaurant businesses purchased and sold in transactions with franchisees and affiliates were not material to the consolidated financial statements for periods prior to purchase and sale.

(In millions)	1998	1997	1996
Minimum rents	**$1,440.9**	$1,369.7	$1,350.7
Percent rent and service fees	**2,026.9**	1,836.3	1,689.7
Initial fees	**58.7**	66.3	75.4
Revenues from franchised and affiliated restaurants	**$3,526.5**	$3,272.3	$3,115.8

Future minimum rent payments due to the Company under franchise arrangements are:

(In millions)	Owned sites	Leased sites	Total
1999	$ 905.0	$ 670.6	$ 1,575.6
2000	887.8	660.3	1,548.1
2001	872.2	651.6	1,523.8
2002	854.1	638.0	1,492.1
2003	835.8	625.4	1,461.2
Thereafter	7,412.1	5,774.0	13,186.1
Total minimum payments	$11,767.0	$9,019.9	$20,786.9

At December 31, 1998, net property and equipment under franchise arrangements totaled $8.7 billion (including land of

$2.6 billion) after deducting accumulated depreciation and amortization of $2.9 billion.

Segment and geographic information

The Company operates exclusively in the food service industry. Substantially all revenues result from the sale of menu products at restaurants operated by the Company, franchisees or affiliates. The Company's reportable segments are based on geographic area. All intercompany revenues and expenses are eliminated in computing revenues and operating income. Operating income includes the Company's share of operating results of affiliates after interest expense. These amounts are also after income taxes for affiliates outside the U.S. Royalties and other payments received from subsidiaries outside the U.S. were (in millions): 1998–$526.0; 1997–$470.6; 1996–$419.0.

The corporate component of operating income represents corporate selling, general and administrative expenses. Corporate assets include corporate cash, investments, asset portions of financing instruments, deferred tax assets and certain intangibles.

The Other segment includes Canada, Africa and the Middle East.

(In millions)	**1998**	1997	1996
U.S.	**$ 4,868.1**	$ 4,602.7	$ 4,590.3
Europe	**4,466.7**	3,931.5	3,613.8
Asia/Pacific	**1,633.2**	1,522.8	1,272.8
Latin America	**814.7**	709.2	595.7
Other	**638.7**	642.6	613.9
Total revenues	**$12,421.4**	$11,408.8	$10,686.5
U.S.	**$ 432.3**	$ 404.0	$ 396.0
Europe	**268.0**	229.2	213.4
Asia/Pacific	**97.3**	82.8	66.4
Latin America	**42.9**	35.4	29.1
Other	**40.6**	42.4	38.0
Total depreciation and amortization	**$ 881.1**	$ 793.8	$ 742.9
U.S.	**$ 1,043.9**(1)	$ 1,210.8	$ 1,144.0(2)
Europe	**1,139.8**	1,007.2	953.8
Asia/Pacific	**351.4**	369.1	355.1
Latin America	**184.7**	166.5	113.7
Other	**118.2**	116.3	118.0
Corporate	**(76.1)**	(61.6)	(52.0)
Total operating income	**$ 2,761.9**(1)	$ 2,808.3	$ 2,632.6(2)
U.S.	**$ 7,795.4**	$ 7,753.4	$ 7,553.5
Europe	**6,932.1**	6,005.4	5,925.3
Asia/Pacific	**2,659.7**	2,125.6	2,111.8
Latin America	**1,339.6**	1,177.8	900.3
Other	**678.7**	661.6	622.8
Corporate	**378.9**	517.7	272.3
Total assets	**$19,784.4**	$18,241.5	$17,386.0
U.S.	**$ 445.5**	$ 584.0	$ 882.9
Europe	**870.2**	929.5	945.8
Asia/Pacific	**224.0**	277.3	283.1
Latin America	**236.8**	227.9	172.5
Other	**102.8**	92.5	91.0
Total capital expenditures	**$ 1,879.3**	$ 2,111.2	$ 2,375.3

(1) Includes $161.6 million of Made For You costs and $160.0 million special charge related to the home office productivity initiative.

(2) Includes $72.0 million special charge related primarily to plans to strengthen the U.S. business and reduce ongoing costs.

Total long-lived assets, primarily property and equipment and intangibles, were (in millions): Consolidated 1998–$18,244.4; 1997–$16,706.1; 1996–$16,069.8. U.S. 1998–$7,533.2; 1997–$7,530.7; 1996–$7,234.3.

Income taxes

Income before provision for income taxes, classified by source of income, was as follows:

(In millions)	**1998**	1997	1996
U.S. and Corporate	**$ 804.3**	$1,004.6	$ 933.9
Outside the U.S.	**1,503.1**	1,402.7	1,317.1
Income before provision for income taxes	**$2,307.4**	$2,407.3	$2,251.0

The provision for income taxes, classified by the timing and location of payment, was as follows:

(In millions)	**1998**	1997	1996
U.S. federal	**$267.8**	$336.3	$260.0
U.S. state	**71.4**	66.0	49.4
Outside the U.S.	**382.7**	363.6	336.1
Current tax provision	**721.9**	765.9	645.5
U.S. federal	**32.8**	2.5	(13.2)
U.S. state	**(6.9)**	13.5	1.6
Outside the U.S.	**9.5**	(17.1)	44.5
Deferred tax provision (benefit)	**35.4**	(1.1)	32.9
Provision for income taxes	**$757.3**	$764.8	$678.4

Net deferred tax liabilities consisted of:

(In millions) December 31,	**1998**	1997
Property and equipment basis differences	**$1,121.5**	$1,033.1
Other	**355.2**	426.0
Total deferred tax liabilities	**1,476.7**	1,459.1
Deferred tax assets before valuation allowance(1)	**(561.8)**	(493.1)
Valuation allowance	**45.5**	41.7
Net deferred tax liabilities(2)	**$ 960.4**	$1,007.7

(1) Includes tax effects of loss carryforwards (in millions): 1998–$67.1; 1997–$51.9 and foreign tax credit carryforwards: 1998–$38.5; 1997–$109.9

(2) Net of current tax assets included in Prepaid expenses and other current assets in the Consolidated Balance Sheet (in millions): 1998–$121.5; 1997–$55.8.

The statutory U.S. federal income tax rate reconciles to the effective income tax rates as follows:

	1998	1997	1996
Statutory U.S. federal income tax rate	**35.0%**	35.0%	35.0%
State income taxes, net of related federal income tax benefit	**1.8**	2.1	1.5
Benefits and taxes related to foreign operations	**(3.3)**	(5.2)	(6.8)
Other–net	**(.7)**	(.1)	.4
Effective income tax rates	**32.8%**	31.8%	30.1%

Deferred U.S. income taxes have not been provided on basis differences related to investments in certain foreign subsidiaries and affiliates. These basis differences were approximately $2.2 billion at December 31, 1998, and consisted primarily of undistributed earnings considered permanently invested in the businesses. Determination of the deferred income tax liability on these unremitted earnings is not practi-

cable, since such liability, if any, is dependent on circumstances existing if and when remittance occurs.

Debt financing

Line of credit agreements

The Company has several line of credit agreements with various banks: a $975.0 million line expiring on February 27, 2003, with fees of .06% per annum on the total commitment; a $25.0 million line with a renewable term of 364 days and fees of .07% per annum on the total commitment; and a $500.0 million short-term line expiring in the first half of 1999 with fees of .04% per annum on the total commitment. All agreements remained unused at December 31, 1998. Borrowings under the agreements bear interest at one of several specified floating rates selected by the Company at the time of borrowing. In addition, certain subsidiaries outside the U.S. had unused lines of credit totaling $452.4 million at December 31, 1998; these were principally short-term and denominated in various currencies at local market rates of interest. The weighted-average interest rate of short-term borrowings, composed of commercial paper and foreign currency bank line borrowings, was 6.2% at December 31, 1998 and 1997.

Exchange agreements

The Company has entered into agreements for the exchange of various currencies, certain of which also provide for the periodic exchange of interest payments. These agreements expire through 2008 and relate primarily to the exchange of Deutsche Marks, French Francs, Japanese Yen and British Pounds Sterling. The notional principal is equal to the amount of foreign currency or U.S. Dollar principal exchanged at maturity and is used to calculate interest payments that are exchanged over the life of the transaction. The Company has also entered into interest-rate exchange agreements that expire through 2011 and relate primarily to U.S. Dollars, British Pounds Sterling and Dutch Guilders. The net value of each exchange agreement based on its current spot rate was classified as an asset or liability. Net interest is accrued as either interest receivable or payable, with the offset recorded in interest expense.

The counterparties to these agreements consist of a diverse group of financial institutions. The Company continually monitors its positions and the credit ratings of its counterparties, and adjusts positions as appropriate. The Company does not have significant exposure to any individual counterparty and has entered into master agreements that contain netting arrangements. The Company's current policy regarding agreements with certain counterparties is to require collateral in the event credit ratings fall below A- or in the event that aggregate exposures exceed limits as defined by contract. At December 31, 1998, no collateral was required of counterparties, nor was the Company required to collateralize any of its obligations.

At December 31, 1998, the Company had purchased foreign currency options outstanding (primarily Deutsche Marks, British Pounds Sterling and French Francs) with a notional amount equivalent to U.S. $115.8 million. The unamortized premium related to these currency options was $2.0 million and there were no related deferred gains recorded as of year end. Forward foreign exchange contracts outstanding at December 31, 1998 (primarily British Pounds Sterling, Hong Kong Dollars and Italian Lira) had a U.S. Dollar equivalent of $1,037.9 million.

Guarantees

The Company has guaranteed and included in total debt at December 31, 1998, $102.9 million of 7.2% ESOP Notes Series A and $56.8 million of 7.1% ESOP Notes Series B issued by the Leveraged Employee Stock Ownership Plan with payments through 2004 and 2006, respectively. The Company has agreed to repurchase the notes upon the occurrence of certain events. The Company also has guaranteed certain affiliate loans totaling $285.3 million at December 31, 1998.

Fair values

(In millions)	December 31, 1998 Carrying amount	Fair value
Liabilities		
Debt	$6,249.7	$6,581.8
Notes payable	686.8	686.8
Foreign currency exchange agreements(1)	106.9	120.1
Interest-rate exchange agreements(2)		20.8
Total liabilities	7,043.4	7,409.5
Assets		
Foreign currency exchange agreements(1)	113.4	40.6
Net debt	$6,930.0	$7,368.9

(1) Combined notional amount equivalent to U.S. $2.9 billion.

(2) Notional amount equivalent to U.S. $1.7 billion.

The carrying amounts for cash and equivalents, notes receivable, purchased foreign currency options and forward foreign exchange contracts approximated fair value. No fair value was provided for noninterest-bearing security deposits by franchisees as these deposits are an integral part of the overall franchise arrangements.

The fair value of the debt, notes payable obligations (excluding capital leases) and the currency and interest-rate exchange agreements were estimated using various pricing models or discounted cash flow analyses that incorporated quoted market prices. The Company has no current plans to retire a significant amount of its debt prior to maturity. Given the market value of its common stock and its significant real estate holdings, the Company believes that the fair value of total assets was substantially higher than their carrying value at December 31, 1998.

Debt obligations

The Company has incurred debt obligations through public and private offerings and bank loans. The terms of most debt obligations contain restrictions on Company and subsidiary mortgages and long-term debt of certain subsidiaries. Under certain agreements, the Company has the option to retire debt prior to maturity, either at par or at a premium over par. The following table summarizes these debt obligations, including the effects of currency and interest-rate exchange agreements.

Debt obligations

(In millions of U.S. Dollars)	Maturity dates	Interest rates(1) December 31 1998	1997	Amounts outstanding December 31 1998	1997	Aggregate maturities by currency for 1998 balances 1999	2000	2001	2002	2003	Thereafter
Fixed–original issue(2)		**6.9%**	7.2%	**$ 3,452.6**	$ 2,487.6						
Fixed–converted via exchange agreements(3)		**6.3**	6.1	**(2,072.7)**	(1,869.7)						
Floating		**5.3**	5.6	**357.2**	646.5						
Total U.S. Dollars	1999–2037			**1,737.1**	1,264.4	$ 235.5	$(210.5)	$(302.5)	$ (61.8)	$ (78.1)	$2,154.5
Fixed		**6.2**	7.2	**1,771.6**	1,107.7						
Floating		**4.0**	4.3	**849.9**	1,422.1						
Total Euro-based currencies	1999–2007			**2,621.5**	2,529.8	606.3	467.8	342.1	267.1	311.0	627.2
Fixed		**7.7**	9.2	**529.4**	541.2						
Floating		**5.6**	6.5	**212.3**	255.3						
Total British Pounds Sterling	1999–2008			**741.7**	796.5	129.4	91.2		24.9	164.7	331.5
Fixed		**7.9**	7.8	**157.4**	120.3						
Floating		**2.1**	6.0	**137.9**	107.1						
Total other European currencies(4)	1999–2003			**295.3**	227.4	165.2	76.0	15.6		38.5	
Fixed		**3.8**	3.9	**387.5**	343.6						
Floating		**0.5**	0.6	**322.5**	203.0						
Total Japanese Yen	1999–2023			**710.0**	546.6	53.0	88.4	159.0	79.5	84.8	245.3
Fixed		**8.8**	9.1	**393.2**	286.5						
Floating		**6.8**	7.8	**337.6**	344.5						
Total other Asia/Pacific currencies(5)	1999–2008			**730.8**	631.0	582.1	20.1	23.9	25.9	44.4	34.4
Fixed		**7.4**	9.5	**9.3**	11.5						
Floating		**8.9**	4.6	**84.3**	220.3						
Total other currencies	1999–2021			**93.6**	231.8	19.5	65.8	0.5	0.4	5.1	2.3
Debt obligations including the net effects of currency and interest-rate exchange agreements				**6,930.0**	6,227.5	1,791.0	598.8	238.6	336.0	570.4	3,395.2
Short-term obligations supported by long-term line of credit agreement						(975.0)				975.0	
Net asset positions of currency exchange agreements (included in miscellaneous other assets)				**113.4**	236.0	38.8	11.0	22.1	10.6	9.7	21.2
Total debt obligations				**$ 7,043.4**	$ 6,463.5	$ 854.8	$ 609.8	$ 260.7	$346.6	$1,555.1	$3,416.4

(1) Weighted-average effective rate, computed on a semi-annual basis

(2) Includes $500 million of debentures with maturities in 2027, 2036 and 2037, which are subordinated to senior debt and which provide for the ability to defer interest payments up to five years under certain conditions

(3) A portion of U.S. Dollar fixed-rate debt effectively has been converted into other currencies and/or into floating-rate debt through the use of exchange agreements. The rates shown reflect the fixed rate on the receivable portion of the exchange agreements. All other obligations in this table reflect the net effects of these and other exchange agreements.

(4) Primarily consists of Swiss Francs

(5) Primarily consists of Australian Dollars and New Taiwan Dollars

Leasing arrangements

At December 31, 1998, the Company was lessee at 4,734 restaurant locations through ground leases (the Company leases the land and the Company or franchisee owns the building) and at 5,714 restaurant locations through improved leases (the Company leases land and buildings). Lease terms for most restaurants are generally for 20 to 25 years and, in many cases, provide for rent escalations and renewal options with certain leases providing purchase options. For most locations, the Company is obligated for the related occupancy costs including property taxes, insurance and maintenance. In addition, the Company is lessee under noncancelable leases covering offices and vehicles.

Future minimum payments required under operating leases with initial terms of one year or more are:

(In millions)	Restaurant	Other	Total
1999	$ 570.4	$ 54.8	$ 625.2
2000	553.6	44.4	598.0
2001	539.9	37.5	577.4
2002	519.1	30.6	549.7
2003	494.9	26.5	521.4
Thereafter	4,688.0	152.3	4,840.3
Total minimum payments	$7,365.9	$346.1	$7,712.0

Rent expense was (in millions): 1998–$723.0; 1997–$641.2; 1996–$581.6. These amounts included percent rents in excess of minimum rents (in millions): 1998–$116.7; 1997–$99.4; 1996–$91.4.

Property and equipment

(In millions)	December 31, **1998**	1997
Land	**$ 3,812.1**	$ 3,592.2
Buildings and improvements on owned land	**7,665.8**	7,289.7
Buildings and improvements on leased land	**6,910.4**	6,168.3
Equipment, signs and seating	**2,728.8**	2,345.1
Other	**640.9**	692.9
	21,758.0	20,088.2
Accumulated depreciation and amortization	**(5,716.4)**	(5,126.8)
Net property and equipment	**$16,041.6**	$14,961.4

Depreciation and amortization expense was (in millions): 1998–$808.0; 1997–$726.4; 1996–$673.4.

Employee benefit plans

The Company's benefits program for U.S. employees includes profit sharing, 401(k) (McDESOP) and leveraged employee stock ownership (LESOP) features. McDESOP allows participants to make contributions that are partly matched by the Company. Plan assets and contributions made by McDESOP participants can be invested in McDonald's common stock or among several other investment alternatives. The LESOP and Company contributions to McDESOP are invested in McDonald's common stock.

Executives, staff and restaurant managers participate in profit sharing contributions, McDESOP and shares released under the LESOP, based on their compensation. The profit sharing contribution is discretionary, and the Company determines the amount each year. Total U.S. costs for the above program were (in millions): 1998–$63.3; 1997–$57.6; 1996–$59.9.

Certain subsidiaries outside the U.S. also offer profit sharing, stock purchase or other similar benefit plans. Total plan costs outside the U.S. were (in millions): 1998–$37.5; 1997–$34.1; 1996–$30.6.

Other postretirement benefits and postemployment benefits, excluding severance benefits related to the home office productivity initiative, were immaterial.

Stock options

At December 31, 1998, the Company had three stock option plans, two for employees and one for non-employee directors. Options to purchase common stock are granted at the fair market value of the stock on the date of grant. Therefore, no compensation cost has been recognized in the consolidated financial statements for these plans.

Substantially all of the options become exercisable in four equal installments, beginning a year from the date of the grant, and expire 10 years from the grant date. At December 31, 1998, the number of shares of common stock reserved for issuance under the plans was 187.0 million, including 23.0 million available for future grants.

A summary of the status of the Company's plans as of December 31, 1998, 1997 and 1996, and changes during the years then ended is presented in the following table.

	1998		1997		1996	
Options	Shares *(in millions)*	Weighted-average exercise price	Shares *(in millions)*	Weighted-average exercise price	Shares *(in millions)*	Weighted-average exercise price
Outstanding at beginning of year	**156.3**	**$16.79**	145.5	$14.73	136.2	$11.93
Granted	**33.7**	**25.90**	30.2	23.53	30.0	24.57
Exercised	**(22.8)**	**12.00**	(14.6)	9.63	(15.6)	8.88
Forfeited	**(3.2)**	**21.06**	(4.8)	17.78	(5.1)	16.16
Outstanding at end of year	**164.0**	**$19.32**	156.3	$16.79	145.5	$14.73
Options exercisable at end of year	**64.4**		60.5		53.3	

Options granted each year were about 2% of average common shares outstanding for 1998, 1997 and 1996, representing grants to approximately 11,500, 11,000 and 10,300 employees in those three years. When stock options are exercised, shares are issued from treasury stock.

The average per share cost of treasury stock issued for option exercises was: 1998–$7.00; 1997–$6.47; 1996–$6.53. The average option exercise price has consistently exceeded the average cost of treasury stock issued for option exercises. This is because the Company prefunds the program through share repurchase. Thus, stock option exercises have generated additional capital, since cash received from employees has exceeded the Company's average acquisition cost of treasury stock. In addition, stock option exercises resulted in $319.6 million of tax benefits for the Company during the three years ended December 31, 1998.

					December 31, 1998
	Options outstanding			Options exercisable	
Range of exercise prices	Number of options *(in millions)*	Weighted-average remaining contractual life *(in years)*	Weighted-average exercise price	Number of options *(in millions)*	Weighted-average exercise price
$ 7 to 9	14.3	2.2	$ 7.77	14.3	$ 7.77
10 to 15	44.6	4.6	13.38	26.5	13.14
16 to 23	45.9	7.4	20.45	16.0	19.38
24 to 34	59.2	8.5	25.69	7.6	24.75
$ 7 to 34	164.0	6.6	$19.32	64.4	$14.87

Pro forma net income and net income per common share were determined as if the Company had accounted for its employee stock options under the fair value method of SFAS No. 123 and are presented in the table below.

	1998	1997	1996
Net income–pro forma *(in millions)*	**$1,474.0**	$1,589.3	$1,538.3
Net income per common share–pro forma			
Basic	**1.08**	1.13	1.08
Diluted	**1.05**	1.11	1.05
Weighted-average fair value per option granted	**8.75**	8.41	8.44

For pro forma disclosures, the options' estimated fair value was amortized over their expected seven-year life. SFAS No. 123 does not apply to grants before 1995. Therefore, the pro forma disclosures in the table above do not include a full seven years of grants and therefore, may not be indicative of anticipated future disclosures. The fair value for these options was esti-

nated at the date of grant using an option pricing model. The nodel was designed to estimate the fair value of exchange-raded options which, unlike employee stock options, can be raded at any time and are fully transferable. In addition, such nodels require the input of highly subjective assumptions, ncluding the expected volatility of the stock price. Therefore, n management's opinion, the existing models do not provide a eliable single measure of the value of employee stock options. he following weighted-average assumptions were used to estinate the fair value of these options:

	1998	1997	1996
Expected dividend yield	**.65%**	.65%	.65%
Expected stock price volatility	**18.0%**	18.1%	18.2%
Risk-free interest rate	**5.56%**	6.61%	6.14%
Expected life of options *(in years)*	**7**	7	7

Capital stock

Change in par value

In May 1996, Company shareholders approved an increase in the number of authorized shares of Common Stock from 1.25 billion with no par value to 3.5 billion with $.01 par value. The change in par value did not affect any of the existing rights of shareholders and was recorded as an adjustment to additional paid-in capital and common stock.

Common equity put options

At December 31, 1997, 1.8 million common equity put options were outstanding, all of which expired unexercised in 1998. In 1998, the Company sold 7.3 million common equity put options, of which 1.0 million options were outstanding at December 31, 1998. The options expire at various dates through February 1999. At December 31, 1998, the $59.5 million exercise price of these outstanding options was classified in common equity put options, and the related offset was recorded in common stock in treasury, net of premiums received.

Shareholder rights plan

In December 1988, the Company declared a dividend of one nonvoting Preferred Share Purchase Right (Right) on each outstanding share of common stock. Under certain conditions related to a potential change in control of the Company, each Right entitled certain holders to purchase at the then current exercise price, stock of the Company or the acquiring company having a market value of twice the exercise price. All Rights expired on December 28, 1998.

Quarterly Results

(unaudited)

	Quarters ended December 31		September 30		June 30		March 31	
(In millions, except per share data)	**1998**	1997	**1998**	1997	**1998**	1997	**1998**	1997
Systemwide sales	**$9,316.0**	$8,530.4	**$9,246.2**	$8,799.7	**$9,247.6**	$8,475.1	**$8,169.7**	$7,833.1
Revenues								
Sales by Company-operated restaurants	**$2,304.5**	$2,110.7	**$2,305.7**	$2,158.5	**$2,270.4**	$2,014.1	**$2,014.3**	$1,853.2
Revenues from franchised and affiliated restaurants	**916.2**	841.9	**909.3**	847.5	**910.4**	818.5	**790.6**	764.4
Total revenues	**3,220.7**	2,952.6	**3,215.0**	3,006.0	**3,180.8**	2,832.6	**2,804.9**	2,617.6
Company-operated margin	**418.2**	384.4	**437.5**	402.4	**426.7**	374.0	**350.9**	326.1
Franchised margin	**734.8**	681.3	**737.3**	693.6	**743.9**	667.4	**632.5**	616.1
Operating income(1)	**637.2**	695.2	**835.2**	755.4	**646.8**(2)	743.5	**642.7**	614.2
Net income(1)	**$ 348.5**	$ 410.9	**$ 482.2**	$ 448.9	**$ 357.2**(2)	$ 438.2	**$ 362.2**	$ 344.5
Net income per common share(1)(3)	**$ .26**	$ .30	**$ .35**	$ .32	**$ .26**(2)	$ .31	**$ .26**	$ .24
Net income per common share—diluted(1)(3)	**.25**	.29	**.34**	.31	**.25**(2)	.30	**.26**	.24
Dividends per common share(3)	**$ .04500**	$ .04125	**$ .04500**	$ .04125	**$ .04500**	$ .04125	**$ .04125**	$ .03750
Weighted-average shares(3)	**1,354.3**	1,375.3	**1,362.1**	1,377.0	**1,372.1**	1,379.5	**1,372.8**	1,383.2
Weighted-average shares—diluted(3)	**1,399.1**	1,403.6	**1,404.7**	1,408.9	**1,415.1**	1,414.6	**1,403.9**	1,415.0
Market price per common share(3)								
High	**$ 39 3/4**	$24 13/16	**$ 37 1/2**	$27 3/8	**$ 35**	$ 27 7/16	**$ 30 1/8**	$24 11/16
Low	**28 1/8**	21 1/16	**26 3/4**	22 7/8	**28 9/16**	23 3/8	**22 5/16**	21 1/4
Close	**38 7/16**	23 7/8	**29 7/8**	23 13/16	**34 1/2**	24 3/16	**30**	23 5/8

(1) Includes Made For You costs in 1998 of $5.0 million ($3.4 million after tax) in second quarter; $10.6 million ($7.1 million after tax or $0.01 per share) in third quarter; and $146.0 million ($98.6 million after tax or $0.07 per share) in fourth quarter

(2) Includes $160.0 million special charge related to the home office productivity initiative ($110.0 million after tax or $0.08 per share)

(3) Restated for two-for-one stock split in March 1999

Management's Report

Management is responsible for the preparation, integrity and fair presentation of the consolidated financial statements and Financial Comments appearing in this annual report. The financial statements were prepared in accordance with generally accepted accounting principles and include certain amounts based on management's judgment and best estimates. Other financial information presented in the annual report is consistent with the financial statements.

The Company maintains a system of internal controls over financial reporting including safeguarding of assets against unauthorized acquisition, use or disposition, which is designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation of reliable published financial statements and such asset safeguarding. The system includes a documented organizational structure and appropriate division of responsibilities; established policies and procedures that are communicated throughout the Company; careful selection, training and development of our people; and utilization of an internal audit program. Policies and procedures prescribe that the Company and all employees are to maintain high standards of proper business practices throughout the world.

There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation and safeguarding of assets. Furthermore, the effectiveness of an internal control system can change with circumstances. The Company believes it maintains an effective system of internal control over financial reporting and safeguarding of assets against unauthorized acquisition, use or disposition.

The consolidated financial statements have been audited by independent auditors, Ernst & Young LLP, who were given unrestricted access to all financial records and related data. The audit report of Ernst & Young LLP is presented herein.

McDONALD'S CORPORATION
January 26, 1999

Audit Committee's Report

The Audit Committee is responsible for overseeing the financial reporting process, financial policies and internal controls on behalf of the Board of Directors. In this regard, it helps to ensure the independence of the Company's auditors, the integrity of management and the adequacy of disclosure to shareholders. Representatives of the internal audit function, independent auditors and financial management each have unrestricted access to the Committee and each periodically meet privately with the Committee.

In conformity with its charter, in 1998, among other things, the Committee recommended the selection of the Company's independent auditors to the Board of Directors; reviewed the scope and fees for the annual audit and the internal audit program; reviewed fees for non-audit services provided by the independent auditors; reviewed the annual financial statements and the results of the annual audit with financial management and the independent auditors; consulted with financial management and the independent auditors regarding risk management; reviewed the adequacy of certain financial policies and internal controls; and reviewed significant legal developments.

The Audit Committee, which met five times during 1998, is comprised of three independent Directors: Gordon C. Gray, Chairman, Walter E. Massey and B. Blair Vedder, Jr. Donald G. Lubin serves as secretary in a non-voting capacity.

AUDIT COMMITTEE OF THE
BOARD OF DIRECTORS
OF McDONALD'S CORPORATION
January 26, 1999

Report of Independent Auditors

The Board of Directors and Shareholders
McDonald's Corporation

We have audited the accompanying consolidated balance sheet of McDonald's Corporation as of December 31, 1998 and 1997, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of McDonald's Corporation management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of McDonald's Corporation at December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

ERNST & YOUNG LLP
Chicago, Illinois
January 26, 1999

Advertisement from Hong Kong. Promotion ended September 1998

BOARD OF DIRECTORS

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Retired CEO, Leo Burnett & Co., Inc.

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Chairman, Rio Algom Limited

Enrique Hernandez, Jr.
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Donald Keough
Chairman, Allen & Company Incorporated

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Walter Massey
President, Morehouse College

Andrew McKenna
Chairman and CEO, Schwarz Paper Company

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(Appointed to serve a one-year term in a nonvoting capacity)

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Patrick Donahue
Mary Anne Drummond
Roy Ellis
Kenneth Fong
Edgar Garber
John Hadfield
Robert Hissink
Bill Johnson
Sam Joseph
Ron Knight
Redmond Langan
Ronald Marcoux
Lawrence McCormick
George Mencke
Jack Pettitt
Kim Scrimgeour

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Nacer El Alami *JVP*
Jamal Hamdouch *JVP*

South Africa
Darryl Webb *MGR*

Turkey
Dinc Kizildemir *MGR*

AVP	*Assistant VP*
EVP	*Executive VP*
GVP	*Group VP*
IRP	*International Relationship Partner*
JVP	*Joint-Venture Partner*
MGR	*CEO/President/Managing Director*
PM	*Project Manager*
RM	*Regional Manager*
RVP	*Regional VP*
SRM	*Senior Regional Manager*
SVP	*Senior VP*
VP	*Vice President*


Tako svjež
McFresh
bilni ljetni sendvič
va odreska od mljevenog mesa,
očna rajčica, zelena salata,
vježi krastavci, luk, sir i majoneza
mekanom pecivu sa sezamom.
McDonald's
Restoran za
cijelu obitelj
Advertisement from Croatia. "McFresh. Rich Summer Sandwich."

Go Figure!

The Investor Club meets weekly. For a four-week period, four different members served four different McDonald's Extra Value Meals to the club. **From the following clues,** can you figure out which member brought which meal in which week?

1. One of McDonald's hamburger meals, which Rick didn't bring, was served the week before Chris brought his order.

2. Patty served a meal the week before the club members ate the Filet-O-Fish, which was served the week before the Big Mac meal.

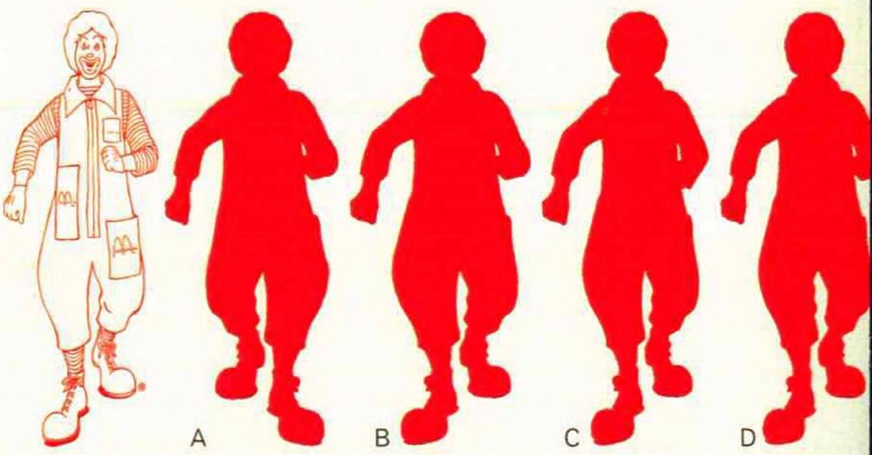
3. The Filet-O-Fish was served earlier in the month than the food brought by Mary.

4. Mary's meal was served earlier in the month than the Chicken McNuggets.

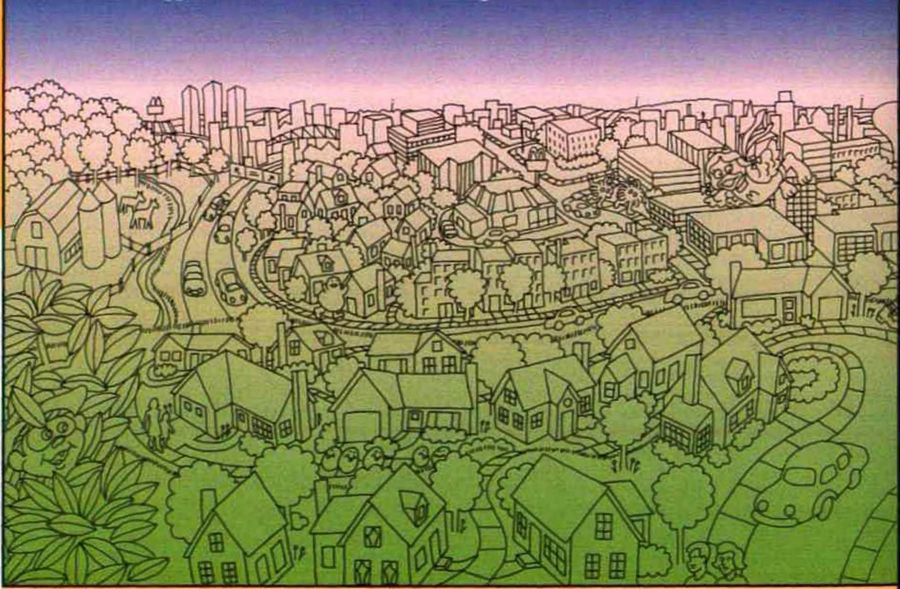
5. Rick and the person who served the Big Mac Extra Value Meal picked up their orders at the drive-thru.

6. The person who brought the Quarter Pounder With Cheese Extra Value Meal and the one who brought the meal for the second meeting picked up their meals at the front counter.

Match Ronald to his exact silhouette.



Can you find Birdie, Grimace, Hamburglar, the Fry Kids, the McNugget Buddies, Ronald's shoe, plus two McDonald's restaurants?



The Breakfast Game for _ _ _ heads

(fill in the blanks)

McDonald's owner/operator Herb Peterson created the _ _ _ McMuffin.

Did you know that countries where McDonald's serves breakfast include the U.S., Canada, Germany, Mexico and Singapore?

The U.S. breakfast line-up includes hotcakes, scrambled _ _ _s, Sausage McMuffin with _ _ _ and the Bacon, _ _ _ & Cheese Biscuit sandwich.

Did you know that most McDonald's markets outside the U.S. don't serve breakfast?... yet.

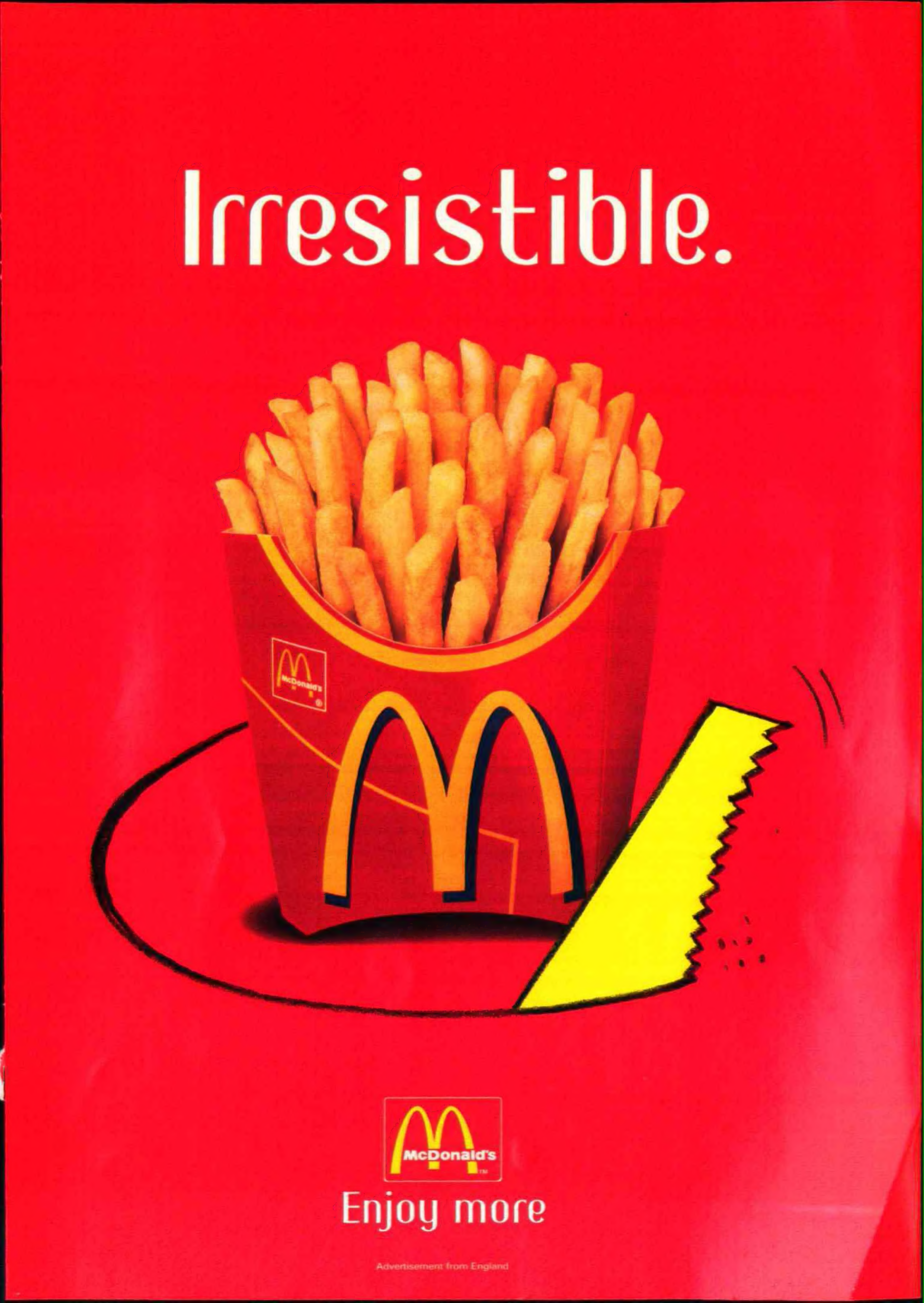
Find all of these terms in the diagram. They may be forward, backward, up, down, and diagonal, but always in a straight line...

Big Mac	Happy Meal
Brand	McDonald's
Crew	McFlurry
Drive-thru	PlayPlace
Egg McMuffin	QSCV
Filet-O-Fish	RMHC
Food Folks Fun	Ronald
Fries	Shake
Golden Arches	Value

D	S	S	U	R	H	T	E	V	I	R	D
I	E	H	M	C	F	L	U	R	R	Y	L
D	H	A	P	P	Y	M	E	A	L	C	A
S	C	K	O	M	B	E	B	V	O	R	N
R	R	E	D	F	Y	I	A	S	Q	E	O
M	A	A	R	Y	M	L	G	S	C	W	R
H	N	I	F	F	U	M	C	M	G	G	E
C	E	D	O	E	N	V	D	N	A	R	B
S	D	A	P	L	A	Y	P	L	A	C	E
L	L	H	S	I	F	O	T	E	L	I	F
F	O	O	D	F	O	L	K	S	F	U	N
D	G	S	D	L	A	N	O	D	C	M	S

...and then, see what the remaining letters spell.

nswers: **The clues:** week 1, Patty, Quarter Pounder With Cheese; week 2, Chris, Filet-O-Fish; week 3, Mary, Big Mac; week 4, Rick, Chicken McNuggets. **Match Ronald:** B. **Breakfast:** Egg. **Term search:** Did Somebody Say McDonald's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